# PROPERTY INSURANCE

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COMPRISING FIRE AND MARINE INSURANCE, CORPORATE SURETY BONDING, TITLE INSURANCE AND CREDIT INSURANCE

BY

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NEW YORK AND LONDON
D. APPLETON AND COMPANY
1916

PRINTED IN THE UNITED STATES OF AMERICA

# PREFACE

THE object of this book is to present the important facts and problems connected with those forms of insurance which grant protection against loss of property. No attempt has been made to discuss the highly technical aspects of the business, because these are presented in numerous manuals, handbooks, and official reports especially prepared for the purpose, reference to many of which is made in the bibliography. Instead, the author's purpose has been to bring together, in compact form, the important theoretical and legal principles and the leading practices upon which the business is based. The book is prepared chiefly as a text-book for students of insurance in colleges and universities who either intend to enter that profession or who wish to understand its nature as a business and its usefulness to the property owner. It is hoped, however, that it will prove equally valuable to the many who are now engaged in the insurance business as agents or brokers.

I desire to acknowledge my obligations to the *American Academy of Political and Social Science* for its permission to use my two articles on "Marine Insurance in the United States" and "Policy Contracts in Marine Insurance," published in its *Annals* for September, 1905; to the publishers of the *Business World* for permission to reproduce parts of

the article on "How Fire Insurance Rates are Made," and of two articles on "Fire Prevention," published in 1907; and to *The Fire Insurance Society of Philadelphia* for the privilege of reprinting parts of an address given before the Society, in 1906, on "State Supervision and Regulation of Fire Insurance Companies." The material of the foregoing articles, however, has been reclassified, and numerous additions have been made. My thanks are also due to the many officials and representatives of insurance companies who have shown me the utmost courtesy in offering suggestions and in furnishing me with "forms" and other information.

Finally, I have to acknowledge, with much gratitude, the intelligent help of Mr. Bruce D. Mudgett, Instructor in Insurance and Commerce at the University of Pennsylvania. I am also under great obligation to Mr. Robert Riegel, who has so cheerfully assisted in the laborious task of reading the proof, verifying the citations and data, and preparing the index. But I need hardly add that these gentlemen are in no way responsible for any mistakes which this book may contain.

S. S. HUEBNER.

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# *PART ONE*

# FIRE INSURANCE

# CHAPTER I

## THE FUNCTIONS OF FIRE INSURANCE[1]

FIRE insurance has been defined as "that social device for making accumulations to meet uncertain losses of capital through fire, which is carried out through the transfer of the risks of many individuals to one person or a group of persons."[2]

All industry involving the ownership of combustible property is more or less subject to risk of loss through fire and the elements, and in all business enterprises it is the desire of the capitalist to eliminate this risk as far as possible. Three methods of elimination may be used: either the capitalist may adopt measures for preventing the origin and spread of fire; or he may decide to carry the risk himself, and as a consequence pay a higher rate of interest on the capital he borrows and puts into the business; or he may buy insurance, and for a definite sum called the premium, transfer the risk to some other person or group of persons called the insurer.

All three of these methods are commonly used by the capi-

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[1] The best treatment of this subject is found in Allan H. Willett's "The Economic Theory of Risk and Insurance." Excellent brief discussions are also found in F. C. Moore's introductory chapter to his work on "Fire Insurance and How to Build," and in Richard M. Bissels's lecture on the "Place of Fire Insurance in the Financial World." These sources, especially the first two, have been drawn on to a considerable extent in this chapter.

[2] Allan H. Willett, "The Economic Theory of Risk and Insurance," Macmillan Co., New York, 1901, p. 106.

talist of to-day, and the cost of each enters into the cost of production. ' The extent to which each is used by the capitalist will depend chiefly upon its relative cost. Statistics, however, conclusively show that during each succeeding decade a larger proportion of the country's wealth, subject to the uncertainty of loss through fire, has been protected by insurance carried by companies. The fire-insurance business of the country, and for that matter insurance along all important lines, has had a most remarkable development during the last twenty-five years. Less and less of the total risk is borne by the capital in the industry, and more and more reliance is placed upon insurance and fire prevention.

1. Viewed from the standpoint of society in general, as contrasted with the individual property owner, the economic value of fire insurance is indirect rather than direct in character. It is apparent that the insurance of property does not in the least reduce the amount of fire waste. During the last fifteen years over $2,633,226,175 worth of property, representing an average annual loss of $175,548,411, has been destroyed by fire in the United States. This enormous amount of property is *wasted* annually by fire, and is gone forever. It is not replaced by insurance, since the insurance company has merely collected premiums from the many whose property is not destroyed, in order to indemnify the unfortunate owners whose property is lost.

If insurance, therefore, does not prevent the destruction of property, and does not directly increase the wealth of the community, to what shall we attribute its principal value? The answer is that the real gain derived from insurance is due to the combination of a large number of separate risks into a group, thus making possible the "substitution of certain for uncertain loss." The larger the number of separate risks combined in a group, the less uncertainty will there be as to the amount of loss, since the law of average can be applied with greater precision; and the less uncertainty of loss,

the smaller is the accumulation of money necessary from the many to meet the losses of the few. In fact, if the aggregate of risks combined in a group were so large as to make the application of the law of average perfect, and thus remove all uncertainty as to the amount of loss that will be experienced during a given period of time, the accumulation of money through premiums from property owners (leaving out of account the expenses and reasonable profits of the insurer) would be limited to the exact amount of the expected loss.

It is in the application of this principle that the nature of the gain to society from the institution of insurance becomes apparent. Thus, let us assume that there are five thousand capitalists, owning five thousand houses, valued at $10,000 each, and alike in all respects. Let us also assume that the *average* annual loss, as shown over a considerable number of years, amounted to ½ of 1 per cent of the value, although for individual years the loss varied from a minimum of ¼ of 1 per cent to a maximum of 1 per cent. Now, were there no system of insurance, it is apparent that these five thousand capitalists, if they wished to eliminate the element of gamble, would have to make a liberal addition to the rental in order to cover the uncertainty of loss by fire, to which each is exposed. How much each would add, is a matter of conjecture, but it is conservative to assume that each would demand at least an extra 1 per cent on his investment, or $100 per year, or $500,000 for the entire group, because of the risk assumed. But even at this extra rate of 1 per cent, these house owners would be making a gamble at odds of 1 to 100. The chances are that, if obliged to assume a risk of such great odds, they would demand much more than the extra 1 per cent.

But let us now assume that these five thousand capitalists combine their risks into one group. It must be clear that by doing this they have substituted for the great *uncertainty* of loss which confronted them as individuals, a certain and defi-

nitely known loss, amounting on the average to $\frac{1}{2}$ of 1 per cent, or $50 per house, and only $250,000 for the group. Without the aid of insurance all these capitalists were obliged to increase their rentals by at least twice the amount needed to cover their losses, and at the end of the year the great majority of them, since they had suffered no losses, would have the entire sum as a net gain, while the unfortunate few would be losers to many times the extra sum charged. In each case the charge for the risk was shifted to the house-renter, and he had to pay considerably more each year than he would have been called upon to pay if the uncertainty of loss had been removed by a system of insurance. "The risk that an insurance company carries is far less than the sum of the risks of the insured, and as the size of the company increases the disproportion becomes greater."[1] Just as the rent payer is benefited, so it can be shown that insurance benefits all consumers, since it reduces the cost of practically all commodities by diminishing that part of the cost of production which the manufacturer must necessarily set aside as a fund for protection against risk.

2. The reduction of the element of uncertainty, resulting from a combination of risks, is by no means the only benefit of insurance to the business community. It is very important that insured risks in different localities and in various classes of property should be correctly inspected and rated, and that justice should be done between different property owners. The ability of men to judge such risks varies greatly, and the problems connected with the fixing of rates are difficult and intricate, since the number of elements which makes up the hazard to which insured property is subject is almost infinite. Any one will recognize the difference between a manufacturing plant and a dwelling from the

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[1] Allan H. Willett, "The Economic Theory of Risk and Insurance." New York, 1901, p. 108.

standpoint of fire hazard, and such distinctions exist between a thousand different types of property. Again, hardly two buildings within a given class of risks can be considered the same, since they differ in their construction, their environment, and their equipment of devices for preventing and extinguishing fires. Almost every substance and process of manufacture will, under certain circumstances, be the cause of fire. According to a leading schedule there are more than a hundred features of construction in a single building which should enter into the determination of its rate. There are nearly forty features of the city or environment which are important, and nearly forty more of fire appliances. Lastly, there must be considered the hundreds of possible uses to which a building may be put.

Naturally the task of estimating risks, when surrounded by so many features, all of which must be taken into consideration, should be undertaken only by those who make this a regular business, i.e., by those who engage in the fire-insurance business. To judge between safe and unsafe risks, and charge rates which are just and adequate, requires that the underwriter should have a knowledge of every business which he agrees to insure. As Mr. F. C. Moore states,[1] "There is probably no calling requiring so intimate a knowledge of every other as this. He who assumes the risk of a flour mill, for example, should know more of its dangers than the miller himself. . . . Drawing a greater number of contracts in a year than do many lawyers in a lifetime, and standing often face to face with the most perplexing questions of jurisprudence, it may be questioned if he should know less than does the attorney who has made it his profession. Seriously affected by every discovery of the chemist, and liable, at any moment, to have his chances of loss on

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[1] F. C. Moore, "Fire Insurance and How to Build," pp. 22 and 23.

whole classes of risks alarmingly increased by new chemical combinations which follow each other as rapidly as the changes of a kaleidoscope, he should know not less of them all than does the chemist himself. In short, there is scarcely a science, art, or manufacture with which he should not be more or less familiar, and if the successful conduct of any one business or calling requires a lifetime of study and application, how much more should the business of insurance —which demands a knowledge more or less intimate of every other—require lifelong study and the closest and most constant observation.'' Facts like these serve to show the importance of having a specialized business for the assumption of the risks of the many producers who are ignorant of the relative fire hazard connected with different types of property. Moreover, the natural ability of the insurers will be constantly developed through the experience and training which their work will give.

3. Insurance also serves a very useful purpose in increasing the efficiency of men by enabling them to venture more willingly. As early as 1601 the British Parliament (43 Elizabeth, C. 12) gave expression to this advantage of insurance by describing marine insurance as a means ''whereby it cometh to pass that upon the loss or perishing of any ship there followeth not the undoing of any one, but the loss lighteth rather easily upon many than heavily upon few, and rather upon them that adventure not, than upon those who do adventure; whereby all merchants, especially those of the younger sort, are allowed to venture more willingly and freely.''

There are many men, who, while capable of engaging in comparatively safe industries, would have their efficiency in business seriously curtailed, if compelled to gamble with the chance of loss through the elements. By being able to transfer these risks of loss to insurance companies for a definite stipulated premium they are relieved from the paralyzing

anxiety which results from uncertainty, and are free to direct their energies along other lines. The value of insurance to the individual property owner, who does not wish to gamble with chance, consists in the diffusion of one individual's loss over a large group of individuals. Insurance takes a loss, sufficiently heavy to ruin one property owner, and by distributing it over thousands of others, who pay premiums to the same company, makes the loss but lightly felt. The losses resulting from the Chicago, Boston, Baltimore, and San Francisco conflagrations would have had a paralyzing influence upon those communities for years if there had been no certain method of indemnifying the losers. But the property owners of these cities carried insurance in scores of companies, situated in nearly every leading country, and representing millions of policy holders in all parts of the world, whose contributions in the form of premiums at once became available for the rebuilding of these cities. Fire insurance "is closely and inseparably interwoven with every scheme of profit and trade, a strong, continuous warp-thread which lends security to the fabric, and without which it is doubtful if the temerity of the capitalists would meet the necessities of the poorer population for employment."[1]

4. But fire insurance plays another very important rôle, besides those already enumerated. It is the support of commerce and industry in so far that it is the basis of our whole credit system. The importance of insurance in this respect becomes apparent when we reflect that it is estimated that only about 5 per cent of the world's business is conducted on a cash basis, and that 95 per cent is based on credit.

A thousand illustrations can be cited to show the far-reaching influence of fire and marine insurance upon our credit system. A cargo of grain is shipped from the United States to Europe, and is paid for through the shipment of

[1] F. C. Moore, "Fire Insurance and How to Build," p. 21.

a cargo of manufactures from Europe to America. Here we have a transaction based on credit and consummated without the use of cash. Commodities are used to pay for commodities, and, owing to the costliness of settling international debts by the actual transfer of gold from one country to another, this practice is almost invariably adopted. The whole transaction is based on credit, and the important thing to remember is that the foreign exchange banker, who undertakes the financial settlement of these two shipments, knows that this credit is guaranteed by a fire and marine insurance policy. The insurance of these cargoes in reliable companies made the transaction as certain as though all payments were made in cash. If the property involved in any of these shipments had been destroyed by fire or by the perils of the sea, the creditors would nevertheless be protected, since the loss would be made good by the insurance companies.

Without fire insurance as collateral security the wholesale merchant could not extend credit to the retailer. But with the goods insured in a reliable company against loss by fire, the wholesale merchant can grant an able and honest retailer credit to the extent of five times his capital, and at the same price he would demand if paid cash. Because of the protection promised by an insurance company the wholesaler advances the goods to the retailer. He knows the retailer to be honest and able, and that when the goods are sold he will receive his payment out of the proceeds of the sale. The only risk is the danger of destruction of the goods before the retailer has sold them, thus probably making their payment impossible. Through insurance this risk is eliminated, and the retailer becomes a cash trader, as far as the securing of favorable terms from the wholesaler is concerned.

In the same way, the wholesaler, if he is operating on borrowed money, can secure the most favorable rate from the lender of credit, if he protects his banker or the manufacturer of the goods with an insurance policy. In buying the

goods the wholesaler may pay only 10 per cent of the purchase price in cash, the remaining 90 per cent being advanced as a loan by the banker or manufacturer, the security for the loan being the goods themselves, but only when insured against loss by fire. Of course the wholesaler or retailer, as the case may be, must pay for the insurance, but the reduced price at which he gets the goods, or the favorable rate of interest at which he secures the credit, pays for this insurance over and over again. As an insurance policy may be made to cover all stock that goes into a store from time to time during the term of the policy, $10,000 of insurance may, in the course of a year, have under its protection from $50,000 to $75,000 worth of merchandise, thus distributing the cost of the insurance over large property values.

It may be shown in another way that fire insurance enables a man with limited capital to transact a business much larger than he otherwise could. Assume a grain dealer to be the possessor of $40,000 capital. With this capital he purchases wheat in the West at $1 a bushel, with a view to selling it in the East or storing it in a warehouse for a more favorable market. If this grain dealer's transactions were limited to cash purchases of wheat, he would probably be obliged to wait several weeks before he could sell his grain and liberate his capital for a new purchase, and his profit would be exceedingly small, since modern competition in that business enables him to realize a profit of only one to two cents per bushel. Grain dealers cannot afford to transact business on this basis, and all are obliged to resort to the use of credit. Instead of limiting his purchases to 40,000 bushels, our dealer will at once have this wheat inspected, graded, represented by warehouse receipts, and will have it insured against loss by fire in a reliable company. Then he will take the warehouse receipts, representing the wheat, and the insurance policy to his banker as collateral security for a loan, and the banker will lend him money, probably, to the

extent of 90 per cent of the value of the wheat, or $36,000. If wheat remains at $1 a bushel, the dealer can at once purchase 36,000 bushels more with the proceeds of this loan. This new purchase of wheat will again be represented by new warehouse receipts, and again protected by a fire-insurance policy, and the warehouse receipts and the policy covering the 36,000 bushels can be offered to the banker as collateral security for a new loan of 90 per cent of the value, or say, $32,400. With this new loan the dealer can at once purchase more wheat, can insure it, and with the new warehouse receipts and the fire-insurance policy as collateral obtain another loan, and with this loan buy more wheat. By repeating the operation until his original capital has been absorbed in margins, it becomes clear that this grain dealer, though he started with only $40,000 capital, is nevertheless enabled, through the use of fire insurance, to do a $300,000 business, and accordingly makes seven or eight times the profit he could realize if his business were restricted to cash transactions. The banker is willing to extend the credit, partly because he knows that wheat always has a ready market on our big produce exchanges, thus in case of a decline in price, giving him a chance to sell the wheat before the margin of ten points on the loan is exhausted and partly because the fire-insurance policy protects him against the loss by fire of the security back of his loans. Likewise the exporter of a cargo of cotton may insure it under a marine policy, and with the policy and bill of lading as collateral may at once command money at the usual rate of interest, with which to buy another cargo and repeat the operation.

Insurance also helps to build homes, since the owner of ground who wants to build a home can borrow a larger sum of money on the building, if insured, and at a more favorable rate, than he could if there were no insurance. Mortgagees, as we shall see in another chapter, invariably have their interest in the mortgagor's property protected by an

insurance policy. In a hundred ways it can be shown that fire and marine insurance have become absolute necessities of trade, without the assuring protection of which the large undertakings of to-day would be a gigantic gamble, and would never be attempted if liable to miscarry through a single fire or marine disaster. As it is, enormous sums are borrowed on stocks and bonds and warehouse receipts; merchants sell their wares on credit; investors furnish millions for the upbuilding of vast industries supporting whole towns; capitalists make loans on buildings worth many times the value of the ground on which they are built—all being willing to do this because they know that the insurance policy stands as collateral between them and loss. "All in all," as Mr. Campbell writes, "no statistics would be possible to show the extent of the fire-insurance business as now practised, for those figures would need to be as large as those of all trade. There is practically no combustible property that is not insured against fire; every car of grain, every scow-load of lumber, every bale of cotton, every package of manufactured goods, from the time it assumes merchantable shape until it is entirely consumed, is thus conditionally the property of insurers. Without such a system, modern commerce would be impossible. The fire-insurance policy, or the assignment of certain interests in it, is attached to the mortgage given by the farmer for money to build his new barn; the fire-insurance policy is as necessary to the banker as is the warehouse or shipping receipt on the strength of which he advances funds for that magic of commerce 'moving the crop'; fire insurance is as important to the manufacturer as is the foundation under his factory; fire insurance is, in fact, the very backbone of that part of our social life which has to do with making, moving, and keeping material things." [1]

[1] A. C. Campbell, "Insurance and Crime," p. 131. Putnam, New York, 1902.

# CHAPTER II

## THE POLICY CONTRACT IN FIRE INSURANCE

A FIRE-INSURANCE policy is a personal contract which promises, in accordance with the restrictions expressed in the policy, to indemnify those who have an insurable interest against all actual direct loss or damage by fire to property as described in the policy. According to the above definition a fire-insurance policy should be viewed as a contract, which, strictly speaking, does not insure the property but the persons who own the property or have an insurable interest therein. The importance of the personal factor in fire insurance cannot possibly be overemphasized. If, for example, we assume two buildings to be alike in all respects except ownership, the insurance company will have to regard these two risks as different as day is from night, if the one is owned by an honest man, and the other by a crook. Dishonest carelessness and actual incendiarism are playing a large share in the enormous annual fire waste of the country, and there is scarcely a business which offers such temptations for gain through criminal procedure as fire insurance. In fact, there is probably no type of contract in which one party (the insurer) is so absolutely at the mercy of the other (the insured). Overinsurance must by all means be guarded against, and yet for the benefit of the general public the company cannot obtain an accurate valuation of the property at the time of insurance. Only an approximate estimate can be made at best, for to do otherwise in the case of all properties insured, would involve a very considerable expense and an unnecessary increase in the rate of premium.

Since the fire-insurance policy must of necessity be regarded as a personal contract, it is clear that the policy does not follow the property unless the company gives its consent. Any other rule would mean that a given property would remain insured even though it passed from an honest and careful owner to a dishonest or careless one, and was thus changed from a good to a bad risk. It is only fair to the company and the public that when a policy is assigned to another person, the company should have an opportunity to know the insurable interest back of the assignment, and to give its consent. Likewise it is only fair that the policy should become null and void if any change takes place in the interest, title, or possession of the subject of the insurance, unless the company has been made acquainted with the fact, and has given its consent to the change.

*The Fire-Insurance Policy a Contract for Indemnity.*— It is a fundamental principle of fire insurance, often lost sight of by our law-making bodies, that the contract is one of indemnity for actual loss. This means that no matter what the stated value of the property may be in the policy, the insurance company is never liable for more than the actual value of the property at the time of the fire. Observation will show that any other rule will work the greatest injustice and make possible wholesale fraud. Values of real estate, and especially of personal property, are constantly changing, and frequently great depreciation in value occurs between the issuance of the policy and the time of loss. Stocks of goods may go down in value because out of season or because of a change in style. Machinery may depreciate through wear and tear, and buildings may be worth less when destroyed because of cheaper labor and building materials, or because they cannot command the same rental as formerly. Now if an insurance company were obliged, in case of a total loss, to pay the full value stipulated in the policy, irrespective of the lower actual value, the policy-holder would

actually be in a position to benefit from fire. This is contrary to the very idea of "indemnity," because that term implies that the insured should be compensated for loss actually incurred, but should never find the insurance contract a source of profit.[1]

In the next place, it should be stated that the fire-insurance contract indemnifies only for actual destruction of *material* values, i.e., for the *fair cash market value* of the property at the time of the loss. In other words, the company is not liable for sentimental values, such as are frequently associated with gifts, portraits, objects of art, documents, heirlooms, etc.

Furthermore liability under the fire-insurance policy is limited to loss or damage which is traceable directly to fire, i.e., where "the damage accrues directly from fire as a destroying agency in contrast to the remoteness of fire as such an agency." There are many instances, for example, where fires of very small size cause enormous loss because of a peculiar chain of circumstances, such as a small fire reaching charged wires, or a spark coming in contact with explosives. The interesting question arises as to the extent of the insurer's liability for such losses. This can only be answered by determining whether or not the loss is directly traceable to fire. Is fire the real cause, and if so, is the sequence of events between the origin of the fire and the destruction of the property (the two may involve locations distantly separated from each other) an unbroken one, or has some outside force, such as an act of God, intervened to bring about or increase the loss? This question is of the greatest importance to both parties in innumerable cases, and will be discussed in greater detail in another chapter.[2]

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[1]Will be discussed at greater length in the chapter on "The Risk Assumed."

[2]See that part of the chapter on "The Risk Assumed" which deals with "The Doctrine of Proximate Cause."

*The Rules Underlying the Interpretation of the Contract.* —Referring to our definition of a fire-insurance contract, we find that "indemnity" as outlined above is promised only "in accordance with the restrictions expressed in the policy." Nearly all of the insurance contract consists of a large number of promissory and restrictive provisions which aim to govern the conduct of the insured in the safeguarding of the property, or to protect the company against the payment of unnecessary or dishonest losses. In considering these provisions, it should be borne in mind that the fire-insurance contract is general in its nature, and was drawn up to meet a general situation, and not with reference to a particular case. And yet there are scarcely two fires in which the circumstances are exactly alike. Innumerable cases arise which require a special application of the general terms of the contract in order to realize the purpose for which the contract was written, viz., to protect against loss.

There is scarcely a provision in the policy to-day which at some time or another was not the subject of interpretation by the courts, and there are few provisions concerning which, largely because of ambiguity in the wording, varying circumstances surrounding the loss, or statutory requirements, there are not conflicting opinions. The principles of fire insurance are but little understood by the general public. The interests of the insured often seem at variance with the interests of the insurer, and the attitude of state legislatures has too often been one of hostility. Nothing seems fairer, for example, than that the company should not pay more than the actual value of the property at the time of the fire. Yet this basic rule, which underlies the very idea of indemnity, is not appreciated or understood in many sections of the country. Its application has actually been prohibited by the legislatures in a large number of the states, and the courts have seen fit to uphold the law. Under these conditions, it is not astonishing to find that disputes should fre-

quently occur as to the interpretation which shall be given to the general provisions of the policy when unexpected circumstances surround the particular loss. Forfeitures are viewed with disfavor by the courts, because the sums involved are usually large. Wherever possible, it is the desire of the court to consider the policy in the light of existing circumstances, and to enforce it for the benefit of the insured, unless, of course, such action would be contrary to the definitely expressed terms of the contract. "In their interpretation," according to Judge Ostrander, "the courts are without any infallible rule to guide them, and necessarily often differ in their judgment of the law, and thus there has come to exist a good deal of conflict among authorities." But, however great this conflict of authority has become, there are certain legal principles which underlie the application and interpretation of all fire-insurance contracts, and which are constantly kept in mind by the courts to assist them in their efforts to enforce the contract. Briefly summarized, these principles are the following:

1. When the wording of any provision in the policy lends itself to more than one construction, the court will give the benefit of the doubt to the insured, and will reject that construction which limits the liability of the company. In Liverpool Insurance Company *vs.* Kearney, 180 U. S., 132, the court explained this rule in the following words: "To the general rule there is an apparent exception in the case of contracts of insurance, namely, that where a policy of insurance is so framed as to leave room for two constructions, the words used should be interpreted most strongly against the insurer. This exception rests upon the ground that the company's attorneys, officers, or agents prepared the policy, and it is its language that must be interpreted."

Contending that this should be the general rule in all cases where the company is free to adopt the policy form, what shall be said of the application of this rule where the

policy form is prescribed by statute law and made compulsory for all companies writing insurance in the state? If the policy is a statute, should its terms not be equally binding upon both parties, or shall the insured still receive the benefit of the doubt? The question was decided favorably to the insured in the case of Matthews *vs.* American Central Ins. Co., 154 N. Y., 449. "The policy," the court declared, "although of the standard form, was prepared by the insurers, who are presumed to have had their own interests primarily in view, and hence, when the meaning is doubtful, it should be construed most favorably to the insured, who had nothing to do with the preparation thereof. Moreover, when a literal construction would lead to manifest injustice to the insured and a liberal but still reasonable construction would prevent injustice by not requiring an impossibility, the latter should be adopted because the parties presumed, when the language used by them permits, to have intended a reasonable and not an unreasonable result."

2. Since insurance policies are general in character and not prepared for particular cases, it follows that special or written agreements must frequently be endorsed on the policy with a view to modifying the original terms of the policy form. Whenever there is a difference in meaning between such indorsements and the policy form itself, it is a universally recognized principle that the superimposed parts of the contract, whether written or stamped or printed, control the regular provisions of the policy. This principle is based on the theory that anything indorsed on the policy must be later in date than the policy itself, and thus represents the latest agreement between the parties. If any ambiguity exists in the wording of any such indorsement, the insured must again be given the benefit of the doubt.

3. Every insurance policy must be regarded as an independent contract, the interpretation of which depends upon its own terms, and should not depend upon or be affected

by the terms of any policy which preceded it. This is an important principle in its application to the renewing of policies, and will be discussed at greater length under that subject.

4. By the weight of authority, a violation of the conditions of the policy will cause a forfeiture only during the time that the violation continues. If, after a violation, the conditions of the policy are again complied with, the policy revives, even though the company never consented to the violation. Unfortunately the courts of the various states have rendered conflicting opinions on this important question of the effect which a violation of its terms will have upon the life of a policy. Thus in New York and Pennsylvania, if a policy-holder vacates his building contrary to the policy and without the consent of the company, the act at once works a forfeiture during the period of vacancy, but if afterward the building is again occupied and a loss then occurs the company will be held liable, because the policy is considered to have revived when the violation was discontinued. In other states, however, such a violation nullifies the policy, and the policy once void will always remain so, unless the insurer consents to its restoration.

*Development of the Standard Policy.*—Having stated the general principles which govern the interpretation of fire-insurance contracts, let us now trace the evolution of the standard policy. At first fire insurance was written almost entirely by individual underwriters whose operations were few in number, and generally confined to risks with which they were personally acquainted. The policy was brief in its terms, and included merely the description of the property, the amount of insurance, the term, and the premium. Soon, however, individual underwriting proved inadequate for the needs of the business community. A prime requisite in insurance is the financial strength of the insurer; and, as business developed in size, larger and larger sums of capi-

tal were necessary to furnish the security demanded by the public. Hence it came about that corporations everywhere began to supplant individuals as underwriters.

At first these corporations solicited insurance directly from their home office. But with the growth of competition between the many companies that were springing up in all the leading Eastern cities, greater and greater reliance had to be placed upon the agency system. Representatives of the companies had to be stationed in the various towns so as to be easily and promptly accessible to property owners. The result was that with the spread of its underwriting activities over a larger geographic area, the company was exposed on the one hand to possible dishonesty or incompetency on the part of the local agent, and, on the other, to an increased moral hazard on the part of the insured. With the creation of agencies in all business communities it was only natural that the company should seek to protect itself and the public against the wilful destruction of property by those who could not now be carefully watched. Many promissory and restrictive provisions had to be incorporated in the policy which would lessen the insured's motive for the destruction of his property. It was essential that the policy should now contain a full description of the property, and, on penalty of forfeiture, prevent concealment of facts prior to the issuance of the policy, and wrongful conduct in the maintenance and care of the property after the owner had secured the policy.

The incorporation of such restrictive provisions tended at this time not only to make the fire-insurance policy a very voluminous contract, but all semblance of uniformity in the wording of different policies seemed to disappear. Each company had a policy of its own. In fact, the policy was local in character, one form prevailing in Boston, another in Philadelphia, and still another in New York. No cooperation of importance existed between the several companies, and the problem was made worse on the one hand, by the

desire of some companies to enhance their business by the issuance of attractive special policies, and, on the other, by the desire of a certain number of companies to defraud the insured of his rightful claim by the strict application of a skilfully drawn policy. The multifarious character of policy forms at this time is well described in a court decision in the following words:[1]

This utter lack of uniformity in fire policies proved to be exceedingly unfortunate for both insured and insurer. The

[1] Delancy *vs.* Rockingham Farmers Mutual Fire Insurance Co., 52 N. H., 581. This decision is also very extensively quoted on pages 182-83 of the "Annals of the American Academy," September, 1905.

"Forms of applications and policies (like those used in this case), of a most complicated and elaborate structure, were prepared and filled with covenants, exceptions, stipulations, provisos, rules, regulations, and conditions, rendering the policy void in a great number of contingencies. These provisions were of such bulk and character that they would not be understood by men in general, even if subjected to a careful and laborious study; by men in general they were sure not to be studied at all. The study of them was rendered particularly unattractive by a profuse intermixture of discourses on subjects in which a premium payer would have no interest. The compound, if read by him, would, unless he were an extraordinary man, be an inexplicable riddle, a mere flood of darkness and confusion. Some of the most material stipulations were concealed in a mass of rubbish on the back side of the policy and the following page, where few would expect to find anything more than a dull appendix and where scarcely anyone would think of looking for information so important as that the company claimed a special exemption from the operation of the general law of the land relating to the only business in which the company professed to be engaged. As if it were feared that notwithstanding these discouraging circumstances, some extremely eccentric person might attempt to examine and understand the meaning of the involved and intricate net in which he was to be entangled, it was printed in such small type and in lines so long and so crowded, that the perusal of it was made physically difficult, painful, and injurious."

policy-holder, scarcely once in a hundred times, carefully studies the policy he procures. When every company issued its own special policy, many of them models of ambiguity, it frequently happened that the insured, when a loss occurred, found himself deprived of the indemnity on which he had confidently relied. The companies, on the other hand, had to contend with a multiplicity of court decisions in the various states, many of which were in direct opposition to others, although dealing with the same subject. Everywhere the courts were called upon to pass on the interpretation of loosely drawn policies, and in their efforts to give the benefit of the doubt to the insured, and prevent a forfeiture on a poorly or skilfully drawn contract, as the case might be, helped to develop a system of court law in insurance, which for its conflicting opinions has probably no parallel in any other line of business. The effect of these decisions is marked even at the present day, although nearly everywhere the same policy is in use. "It would be well," writes Mr. F. C. Moore, "in all cases of lawsuits to bear in mind that when decisions are glibly quoted to sustain interpretations of particular phrases, that the policy in question before the court may have been very differently worded from the standard form now in use."[1] Again, when large fires occurred, and several policies had been written on the property, it was common to find that they were unlike in their terms and application, thus making a settlement of the loss among the several companies impossible, except by an unsatisfactory compromise.

With such inconveniences resulting from a lack of uniformity in the terms, it was only natural that a sentiment should develop for the establishment of a "standard" policy, which when universally used by all companies would in the course of time be definitely interpreted by the courts, thus

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[1] "Fire Insurance and How to Build," p. 556.

enabling the policy-holder to be sure of its meaning. The first important attempt to adopt such a standard policy was undertaken by the National Board of Underwriters in 1867 and 1868. Then followed the law of 1873 in the State of Massachusetts, providing for a standard form of policy, which in 1880 was made obligatory for all companies writing business in the State. Six years later a standard form was adopted by the legislature of New York, and made obligatory in the following year, 1887. This policy, going under the name of the "New York Standard Fire Policy," has been adopted as a statute in a number of other states, and is used wherever permitted by most of the largest companies. (See folder, Fig. 1.) Quite a number of states[1] have adopted special forms of standard policies, differing somewhat but not radically from the New York form. In most of the other states, although not made mandatory by law, the New York policy is generally used by nearly all the companies. It was carefully prepared with reference to past experience, and to quote one who was instrumental in its making "those who framed it brought to their task an honest desire to make a policy which should not only protect the rights of underwriters, but be just to all honest claimants, and the phraseology of the contract was specially designed to meet the construction which had been placed upon ambiguous phrases by the courts of highest resort."[2]

*The Grouping of Provisions in the Policy.*—For purposes of discussion the many provisions of the standard policy may be conveniently classified under the following groups:

1. The parties to the contract.
2. The term of the contract, involving renewal and cancellation.
3. The risk assumed.

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[1]Maine, Massachusetts, New Hampshire, Michigan, Missouri, Virginia, and Wisconsin.

[2]F. C. Moore, "Fire Insurance and How to Build," p. 556.

4. The description of the property insured.

5. Other insurance on the same property, involving contribution.

6. The privileges, which if desired, must be indorsed on the policy.

7. Policy provisions going into effect after a loss has occurred

As regards each of these groups, the provisions of the standard policy will be discussed in the following chapters with reference to their purpose and meaning, and the interpretation which has been placed upon them by the courts.

# CHAPTER III

## PARTIES TO THE CONTRACT—THE INSURED

In the preceding chapter it was explained that a fire-insurance policy is essentially a personal contract, and that to eliminate the moral hazard as much as possible, it is important that the insured should have an interest in the property which he wishes to insure. Fire-insurance policies are contracts for indemnity and not contracts for profit. Where the insured has no "insurable interest" in the property covered by the policy there can be no loss, and hence no indemnity.

In life insurance, as contrasted with fire insurance, this principle of indemnity has not been clearly defined. Not only have the courts decided that a person has an insurable interest in his own life for any amount for which he may be willing to pay premiums, but as regards the insurable interest of blood relatives in the life of the insured, and in many states even as regards the interest of creditors, the tendency has been not to lay down hard and fast rules as to the amount of insurance that may be taken. In fact, most legal authorities do not regard life-insurance policies as contracts for indemnity, but view them as agreements for the payment of a definite sum "upon the happening of a certain event at an uncertain time in the future."

"Insurable interest," as applied to fire-insurance contracts, has been defined as "every interest in property or in relation thereto or liabilty in respect thereof, of such a nature that a contemplated peril may directly damnify the in-

sured."[1] Every person who has such an insurable interest in property has the right to insure the same under a fire or marine insurance policy. It is to be noted, however, that the definition is exceedingly broad in its scope, and that insurable interest does not necessarily imply ownership or possession of the property. Insurable interest may assume hundreds of forms, and may exist under very different conditions. Elliott, in his legal treatise on "The Law of Insurance," briefly summarizes the nature of the interest as follows: "The interest which may be insured must be neither illegal nor immoral. It may be either legal or equitable, but it is not necessary that the party should have either legal or equitable title to the property. The interest may be either conditional or contingent. . . . An insurable interest does not imply ownership of the property or even a right to its possession. A person may insure his interest in expected commissions, or, in what seems an extreme case, an expected catch of fish. But in all such cases an expectation of profit or benefit must arise out of some subject in which the party is actually interested at the time of the loss, and it is not enough that he only expects to be interested in such property."[2]

*The Time and Continuity of Insurable Interest.*—The weight of early legal decisions is to the effect that a fire-insurance policy could only be supported by an insurable interest that existed both when the contract was made as well as at the time of the loss. In more recent years, however, the courts have shown a strong tendency to view the insurable interest supporting a fire policy as similar to that applying in life and marine insurance. In the last form of insurance it has always been the rule that an insurable interest, existing at some time during the risk and at the time of

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[1] Elliott on Insurance, p. 40.
[2] Ibid., p. 44.

the loss, was sufficient to validate the policy, and that it was unnecessary to have the interest exist at the time the policy was written. The vicissitudes of marine ventures, especially where voyages are long and to remote countries, have made this ruling a necessity. Thus in marine underwriting it has always been a common practice to insure vessels and cargoes "lost or not lost," meaning that even though the property is lost when the policy is written, the company will indemnify the owner when information of the loss shall be obtained. Again, it may frequently be convenient for merchants, where long distances are involved and communication is difficult, to insure cargoes before it is definitely known that they have begun the voyage. Freight earnings in marine ventures are also insured against loss before they are earned.

A number of recent court decisions point to the fact that there never was any good reason for making a distinction between fire insurance and life and marine insurance as regards the necessity of insurable interest at the time of the inception of the policy. Thus in the case of Sun Insurance Office *vs.* Merz (64 N. J., p. 303), the court gives the following explanation: "This was formerly considered to be the rule with relation to fire policies, and was so declared both by text-writers and in decided cases, although a contrary view was always taken in construing life and marine policies. Why any such variance in construction existed, it is difficult to understand, for certainly if a contract to insure after-acquired property against fire is a wagering contract, and therefore void because against public policy, a contract to insure such property against marine risks, or a contract to insure the life of a person in favor of one who at the time of the taking out of the policy has no interest therein, are equally wagering contracts; and if such contracts are prohibited by public policy, should equally be considered void. But, although the earlier cases on fire in-

surance laid down the rule enunciated by the Supreme Court, experience has taught that the necessities of business and the adequate protection of property require the same methods of insurance against loss by fire as have always existed with relation to losses by the perils of the sea. And reflection has led to the conclusion that contracts of insurance upon property in which the insured has no interest at the time of the issuance of the policy are not wagers if he acquires an interest during the life of the policy and retains it at the time when the loss occurs."

The question that next suggests itself has reference to the continuity of the interest. Assuming that an insurable interest exists, either at or some time after the issuance of the policy, must this interest continue without a break until the time of the loss, in order to keep the policy in force, or may the interest cease for a time and then be restored without invalidating the insurance? The answer to this question is well presented by Elliott. "In those jurisdictions," he writes, "which hold that the interest need not exist at the time the policy is taken out, it is sufficient if it exists at some time during the risk and at the time of the loss. But policies now generally contain a provision forbidding a change of title or the alienation of the property under a penalty of forfeiture. This provision is effective, but in its absence the contract is merely suspended during the time the interest is gone, and revives to secure the new interest acquired before the loss."[1]

*Examples of Insurable Interest.*—As already explained, insurable interest in property may assume a great variety of forms, not at all dependent upon ownership or possession; and it consequently follows that several parties may have such an interest in the same subject matter. Thus custodians and caretakers, such as administrators of estates,

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[1] Eliott on Insurance, p. 43.

assignees in insolvency, trustees, receivers, and contractors, have an insurable interest in the property entrusted to their care. The mortgagor has such an interest as the owner of the property, and the mortgagee an interest in the same property to the extent of the mortgage debt. The lessor and lessee have an insurable interest in the same property. The consignor and consignee of goods may both have an interest to protect, and the same is true of the vendor and vendee of property before the absolute transfer has been made. All persons, although possessing no ownership in the property, have an insurable interest therein if liable to the owners for the loss or destruction of the same. Transportation companies, warehousemen, and all parties similarly situated, may protect themselves against liability imposed by law or custom by insuring the property left within their care. And it has been decided by the courts that a railroad company has an insurable interest in the property of others, situated along its line, for which it is legally liable in case of destruction. Even where the interest is of such a contingent nature that circumstances may defeat the same, the courts have declared that this indefinite nature does not prevent the interest from being insurable.

In fact so broad has been the application of the theory of insurable interest to fire-insurance contracts that comparatively few instances are found where all the court cases agree that no insurable interest exists. In the case of parties to void contracts, trespassers, or persons interested in property which cannot be legally owned or operated, the courts with one accord have denied the existence of such an interest. But in many of the doubtful cases, as, for instance, where a remote pessibility exists that a right in property may arise, which, however, may be destroyed by the occurrence of some event, or where a person has made voluntary advances, or is only a general creditor, there are found conflicting decisions, some of which concede the existence of an insurable

interest, whereas others deny the same. In view of the many distinct interests that may arise, the following list of insurable interests recognized by law has been compiled from the almost unlimited number that may be found in the many court cases and legal treatises.

## EXAMPLES OF INSURABLE INTEREST

| Parties Possessing Insurable Interest. | Nature of the Insurable Interest. | Citation of Authority. |
|---|---|---|
| 1. Beneficiaries ... | In the property by which they are to benefit. | Am. Basket Co. *vs.* Farmville Ins. Co., 3 Hughes (U. S.), 251. |
| 2. Consignors of goods ....... | In the goods consigned. | Hibbert *vs.* Carter, 1 T. R., 745. |
| 3. Creditors: | | |
| Lien creditors | In property to which lien attaches. | Royal Insurance Co. *vs.* Stenson, 103 U. S., 25. |
| Creditor in goods ...... | In goods which he has sold under an agreement providing for payment out of proceeds of sale. | Roos *vs.* Merchants' Mutual Ins. Co., 27 La. A., 409. |
| Attaching creditor .... | In property attached or levied upon. | Hancox *vs.* Fishing Ins. Co., 3 Sumner (U. S.), 132. |
| Judgment creditor .... | In property of debtor upon which judgment is a lien. | Spare *vs.* Home Mutual Ins. Co., 15 Fed. Rep., 707; Rohrback *vs.* Germania Fire Ins. Co., 62 N. Y., 47. |
| 4. Custodians and Caretakers: | | |
| Administrator | In the property of the estate. | Shepard *vs.* Peabody Ins. Co., 21 W. Va., 368. |
| Persons ...... | In possession of the property under agreement to care for, rent, and keep insured. | Cross *vs.* National Fire Ins. Co., 132 N. Y., 133. |

EXAMPLES OF INSURABLE INTEREST—*Continued*

| Parties Possessing Insurable Interest. | Nature of the Insurable Interest. | Citation of Authority. |
| --- | --- | --- |
| Contractors and builders.. | In buildings under construction, payment for which is to be received when completed. | Germania Fire Ins. Co. *vs.* Thompson, 43 Kan., 567. |
| Assignee in insolvency...... | In the assigned property. | Herkimer *vs.* Rice, 27 N. Y., 163. |
| Trustee ........ | In the trust property. | Young *vs.* Union Ins. Co., 24 Fed., 279. |
| Receivers ...... | In property held in receiver's hands. | Thompson *vs.* Phœnix Ins. Co., 136 U. S., 287. |
| Sheriffs and marshals ..... | In property seized in execution. | White *vs.* Madison, 26 N. Y., 117; Cramer *vs.* Oppenstein, 16 Colo., 495. |
| Agents......... | In property held for their principal. | Phœnix Ins. Co. *vs.* Hamilton, 14 Wall. (U. S.), 504. |
| Bailee or depository ......... | In goods deposited with. | Commonwealth *vs.* Hide and Leather Ins. Co., 112 Mass., 136; White *vs.* Madison, 26 N. Y., 117; Calif. Ins. Co. *vs.* Union Compress Co., 133 U. S., 387. |
| Commission merchants.... | In goods in their possession. | Home Ins. Co. *vs.* Balt. Warehouse Co., 93 U. S., 527; Phœnix Ins. Co. *vs.* Hamilton, 14 Wall. (U. S.), 504. |
| Common carriers ......... | In goods being transported. | Phœnix Ins. Co. *vs.* Erie Transp. Co., 117 U. S., 312. |
| Consignees ..... | In goods held for sale or in advances made. | Seaman *vs.* Loring, 1 Mason (U. S), 127. |

EXAMPLES OF INSURABLE INTEREST—*Continued*

| Parties Possessing Insurable Interest. | Nature of the Insurable Interest. | Citation of Authority. |
|---|---|---|
| Warehousemen . | In goods stored. | Home Ins. Co. *vs.* Balt. Warehouse Co., 93 U. S., 527; Phœnix Ins. Co. *vs.* Erie Transp. Co., 117 U. S., 312; Richmond *vs.* Niagara Ins. Co., 79 N. Y., 230. |
| 5. Debtors........ | In property seized for debt. | Lockyer *vs.* Offley, 1 T. R., 261; Cone *vs.* Niagara Fire Ins. Co., 60 N. Y., 619. |
| 6. Heirs .......... | In property of decedent. | Herkimer *vs.* Rice, 27 N. Y., 163. |
| 7. Husband ....... | In property of his wife. | Cohn *vs.* Va. F. & M. Ins. Co., 3 Hughes (U. S.), 272; Trade Ins. Co. *vs.* Barracliff, 45 N. J. L., 543, contrary; Agric. Ins. Co. *vs.* Montague, 38 Mich., 548; Clarke *vs.* Firemen's Ins. Co., 18 La., 431. |
| 8. Indorsers and sureties .... | In property of the guaranteed. | Russell *vs.* Union Ins. Co., 1 Wash. (U. S.), 409; Firemen's Ins. Co. *vs.* Powel, 13 B. Mon. (Ky.), 311. |
| 9. Infants, or guardians in their behalf. | In the infant's property. | New Hamp. Mutual Fire Ins. Co. *vs.* Noyes, 32 N. H., 345; Monaghan *vs.* Agric. Fire Ins. Co., 53 Mich., 238. |
| 10. Insurers........ | In property reinsured. | Hastie *vs.* De Peyster, 3 Cai (N. Y.), 190. |
| 11. Landlord....... | In the goods of his tenant which are liable to distress. | Columbia Ins. Co. *vs.* Cooper, 50 Pa. St., 331. |

EXAMPLES OF INSURABLE INTEREST—*Continued*

| Parties Possessing Insurable Interest. | Nature of the Insurable Interest. | Citation of Authority. |
|---|---|---|
| 12. Lessee ......... | In property held under lease. | Hidden *vs.* Ins. Co., 2 Cliff (U. S.), 266; Georgia Home Ins. Co. *vs.* Jones, 49 Miss., 80. |
| 13. Lessor.......... | As owner, in property leased. | Hidden *vs.* Ins. Co., 2 Cliff (U. S.), 266 |
| 14. Married women. | In their personal property, separate estate, or property held conjointly with husband. | Queen Ins. Co. *vs.* Young, 86 Ala., 424. |
| 15. Mortgagee ..... | To extent of mortgage debt on property. | Carpenter *vs.* Providence Wash. Ins. Co., 16 Pet. (U. S.), 495. |
| 16. Mortgagor...... | To full value of property mortgaged. | Carpenter *vs.* Providence Wash. Ins. Co., 16 Pet. (U. S.), 495. |
| 17. Occupants...... | In property occupied, if insurance is for benefit of owner. | Fire Ins. Asso. of Eng. *vs.* Merch. Transp. Co., 66 Md., 339. |
| Owner of title of property out of which an expectancy arises ..... | In the expectancy. | Putnam *vs.* Mercantile Ins. Co., 5 Metc. (Mass.), 386, 392. |
| 18. Owner of land. | In buildings in process of construction upon the land. | Foley *vs.* Manufg. & B. Fire Ins. Co., 152 N. Y., 131. |
| 19. One who has expended money upon another's property with owner's consent. | In property upon which the money is expended. | Looney *vs.* Looney, 116 Mass., 283. |
| 20. Partner ........ | In the entire property of the firm, in his interest separately; or for the firm in the firm's name. | Page *vs.* Fry, 2 B. & P., 240; Peoria M. & F. Ins. Co. *vs.* Hall, 12 Mich., 202. |

## EXAMPLES OF INSURABLE INTEREST—*Continued*

| Parties Possessing Insurable Interest. | Nature of the Insurable Interest. | Citation of Authority. |
|---|---|---|
| 21. Partnerships ... | In the firm's property. | Georgia Home Ins. Co. *vs.* Hall, 94 Ga., 630. |
| 22. Part owners ... | In their respective interests. | Turner *vs.* Burrows, 5 Wend. (N. Y.), 541; affd., 8 Wend. (N. Y.), 145. |
| 23. Pledgees ....... | To full value of goods held in pledge. | Wells *vs.* Phila. Ins. Co., 9 S. & R. (Pa.), 103. |
| 24. Purchaser ...... | In possession under contract of purchase and who will receive deed upon payment of purchase money. | Loventhal *vs.* Home Ins. Co., 112 Ala., 108. |
| 25. Purchaser ...... | Who has secured possession under oral contract and has paid part of the purchase money. | Amsinck *vs.* American Ins. Co., 129 Mass., 185. |
| 26. Purchaser ...... | At execution sale, though he has not received deed. | Cushing *vs.* Thompson, 34 Me., 496; Ætna Ins. Co. *vs.* Miers, 5 Sneed (Tenn.), 139. |
| 27. Railroad companies ...... | In property along right of way. | Eastern R. Co. *vs.* Relief Fire Ins. Co., 98 Mass., 420. |
| 28. Remaindermen. | In premises. | Addis *vs.* Addis, 14 N. Y., Supp., 657; Brough *vs.* Higgins, 2 Gratt. (Va.), 408. |
| 29. The State ...... | As trustee for the people. | People *vs.* Liverpool Ins. Co., 2 Thomp. (N. Y.), 268. |
| 30. Stockholders ... | In property of a corporation. | Seaman *vs.* Enterprise F. & M. Ins. Co., 18 Fed. Rep., 250; 5 McCrealy (U. S.), 528. |
| 31. Tenants: For life ...... | To full value of property. | Berry *vs.* Am. Cent. Ins. Co., 30 N. Y. St. Rep., 53; 132 N. Y., 49. |

## EXAMPLES OF INSURABLE INTEREST—*Continued*

| Parties Possessing Insurable Interest. | Nature of the Insurable Interest. | Citation of Authority. |
|---|---|---|
| Tenants—For limited term.. | To value of tenement for occupation. | Niblo *vs.* N. Am. Fire Ins. Co., 1 San. (N. Y.), 551. |
| 32. Vendee......... | In property the destruction of which will cause him pecuniary loss. | Columbian Ins. Co. *vs.* Lawrence, 2 Pet. (U. S.), 25. |
| 33. Vendor......... | In property sold, until absolute transfer takes place. | Bates *vs.* Equit. Ins. Co., 10 Wall. (U. S.), 33. |

# CHAPTER IV

## THE MORTGAGE CLAUSE

ONE of the most common cases where more than one party has an insurable interest in the same property arises in connection with the mortgagee's interest. In a long line of decisions the principle has been recognized that both the mortgagor and the mortgagee possess an interest in the mortgaged property which each may insure separately, without violating that section of the policy which provides against double insurance. The mortgagor, as owner of the property, may insure the same to the extent of its value, and the mortgagee, as creditor, may effect insurance to the extent of his interest. Both parties may secure insurance without consulting each other, or without giving notice to or receiving the consent of the other insurer. In brief, the courts regard the two insurances as covering separate insurable interests, and hold that where the mortgagee has taken out a policy in his own name and pays the premium, the mortgagor is to be considered a stranger to the contract.

*Where the Mortgagee Insures His Own Interest.*—Where the mortgagee pays the premium, and insures his interest in his own name, the courts have held that the mortgagor in no way has an interest in the benefits derived from the insurance and the indemnity paid cannot be applied to the payment of the mortgage debt. Now if the mortgagor is not relieved from his debt and the mortgagee is entitled to the proceeds of his policy, it would seem that the mortgagee might receive two payments for one debt. This would mani-

festly be contrary to justice, and would certainly give rise to strong temptations to commit fraud, especially where the property securing the mortgage consisted of separate items whose aggregate value far exceeded the mortgage debt.

To avoid such double payments it is a well-established legal principle that upon the payment of a loss to the mortgagee the insurance company will be subrogated to the mortgage or other evidence of debt, i.e., will become entitled to all the rights which the mortgagee had in the mortgage or in the insured property. If the company, now the holder of the mortgage, can collect the same when it matures, it will be reimbursed; but in case this cannot be done, it, and not the mortgagee, will be the loser. If the loss is less than the sum to which the mortgagee is entitled, the company is subrogated with the right to collect the loss, but in this case, it should be noted, that the company's rights are subordinate to those of the mortgagee. If, after a loss has been paid, there still remains a portion of the property, the company cannot prejudice the mortgagee's right to this security and the collection of the balance of the debt. The company is subrogated to so much of the mortgage as it has paid, and is only entitled to that portion of the remaining property as will not be needed to protect the mortgagee's interest in the balance of the debt not yet paid.

*When the Mortgagee's Interest is Joined with that of the Mortgagor.*—While the mortgagee's interest may be insured directly and separately, it is the desire of the companies to avoid this wherever possible. It is considered by the companies as much the best method to issue the policy in the name of the owner, i.e., the mortgagor, and join the two interests by providing in the policy that the loss, if any, should be payable to the mortgagee. This will enable a company to maintain a better supervision over the policy, will reduce the possibilities of fraud, and will eliminate the

complications which may arise when the two interests are insured in different companies.

The practice of protecting the mortgagor's and mortgagee's interests in the same policy has had an interesting development. Various methods have been used at different times to accomplish this end, but all have given way to the modern so-called "mortgage clause." In the first place, the mortgagor may take out the policy in his own name, and then assign it to the mortgagee. This method was at one time in vogue, but is dangerous as far as the protection of the mortgagee's interest is concerned, because the validity of the policy, when an assignment is made without an actual transfer of the property, will depend upon the mortgagor's actions or negligence. In law the mortgagor is still the policy-holder, and as such his acts or omissions may cause a forfeiture of the policy. It is thus seen that the protection of the mortgagee is dependent upon the conduct of the mortgagor, over whom he may not be able to exercise any supervisory control. Again, if the mortgagor has violated the policy and a forfeiture exists at the time of the assignment, the mortgagee's interest is unprotected because of the rule that in making the assignment, the assignor can give only what he possesses, i.e., in this case an invalid policy.

Secondly, the mortgagor may insure his property and make it payable to the mortgagee "as his interest may appear." But this method has been variously interpreted by the courts and, generally speaking, has proved itself to be subject to the objections mentioned under the first method. To join the two interests in the same policy and be just to the mortgagee, it is necessary that he be protected against a forfeiture of the policy through the acts of the owner of the property. This is done to-day through the general use of the "mortgage clause." The mortgagor will take out the policy in his own name, and to protect the mortgagee's interest a special clause is indorsed on the policy, according

to which the company agrees to protect his interest as it may appear, regardless of the conduct of the mortgagor as concerns the provisions of the policy. The clause usually reads as follows:

## NEW YORK, NEW JERSEY, CONNECTICUT, AND RHODE ISLAND STANDARD MORTGAGEE CLAUSE

Loss or damage, if any, under this policy shall be payable to ................................as......................mortgagee (or trustee) as interest may appear, and this insurance, as to the interest of the mortgagee (or trustee) only therein, shall not be invalidated by any act or neglect of the mortgagor or owner of the within described property, nor by any foreclosure or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy; provided that in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall, on demand, pay the same.

Provided, also, that the mortgagee (or trustee) shall notify this company of any change of ownership or occupancy or increase of hazard which shall come to the knowledge of the said mortgagee (or trustee) and unless permitted by this policy, it shall be noted thereon and the mortgagee (or trustee) shall, on demand, pay the premium for such increased hazard for the term of the use thereof; otherwise this policy shall be null and void.

This company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for ten days after notice to the mortgagee (or trustee) of such cancellation, and shall then cease, and this company shall have the right, on like notice, to cancel this agreement.

Whenever this company shall pay the mortgagee (or trustee) any sum for loss or damage under this policy and shall claim that, as to the mortgagor or owner, no liability therefor existed, this company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may, at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with in-

**terest, and shall thereupon receive a full assignment and transfer of the mortgage and of all such other securities; but no subrogation shall impair the right of the mortgagee (or trustee) to recover the full amount of........claim.**

**Dated....................**

**Attached to and forming part of Policy No........of the (Name of Company).**

**..............................**

**Signature for the Company.**

*The Application of the Clause.*—By indorsing the above clause on the mortgagor's policy, the company specifically agrees that the insurance on the mortgagee's interest shall not be invalidated for various reasons, including the acts and neglect of the owner of the property. The company also agrees to give the mortgagee ten days notice before cancelling the policy according to its terms; and provides that upon the payment of a loss it shall be subrogated to all the rights possessed by the mortgagee in all the securities held as collateral to the mortgage debt, but that "no subrogation shall impair the right of the mortgagee to recover the full amount of his claim. In return for these privileges the mortgagee agrees to pay upon demand any premium which the mortgagor may neglect to pay, or upon demand to pay the premium for any increased hazard connected with the property. He also promises that he will notify the company of any change of ownership or occupancy or increase of hazard which shall come to his knowledge. With but few exceptions the courts have enforced these promises. On the other hand, the effectiveness of the protection granted under the mortgage clause has also repeatedly been affirmed. In the opinion of Judge Rapallo (Hastings *vs.* Westchester Fire Insurance Company, 73 N. Y., p. 153) [1] "The intent of this clause was that in case, by reason of any act of the mortgagors

**[1]Also see Ostrander on "Fire Insurance," pp. 351, 352.**

or owners, the company should have a defense against any claim on their part for a loss, the policy should, nevertheless, protect the interest of the mortgagees, and operate as an independent insurance of that interest, and indemnify them against loss resulting from fire, without regard to the rights of the mortgagors under the policy; and that, to effectuate that intention, we should hold that, as against the mortgagees, the defendant cannot set up any defense based upon any act or neglect of the mortgagors, whether committed before or after the issuing of the policy, or the making of the agreement between the company and the mortgagees."

While the mortgage clause constitutes an independent agreement between the company and the mortgagee, and recognizes the mortgagee as possessing independent rights, it is essential to bear in mind that the clause is of no effect, except as it is made a part of the policy. With the exception of the agreements contained in the clause, the mortgagee is bound by all the provisions of the policy. As Mr. Ostrander puts it: "Should a forfeiture occur as to the mortgagor, by sale or otherwise, the mortgagee will continue the only person insured, and, a fire subsequently happening, it will become his duty to perform all things under the terms of the policy subsequent to the loss. . . . He is the 'assured,' and the only person under the terms of the policy who sustains toward the insurance company any beneficial relations, and on him, by mutual agreement, falls the duty of performance."

It should be stated here that there are a few instances where the insurer will not be liable under the mortgage clause. A policy which has become void will not be revived by attaching thereto a mortgage clause for the benefit of a mortgagee. In many cases it has been decided that no new rights are created in behalf of the mortgagee by such an act, and that the policy cannot be revived without a new agree-

ment of the parties, supported by a new consideration."[1] Also where the mortgagee has acted in bad faith, or has secured the promise of protection through misrepresentation or with a view to committing fraud, he will not be protected under the mortgage clause.[2] The clause is not intended to afford protection to the mortgagee against his own wrongdoing. Its whole object is to protect him against misconduct of the mortgagor, whose acts he may not be in a position to control.

*Contribution Under the Mortgage Clause.*—As will be explained more fully in a later chapter, the standard policy provides that in case several policies have been written on the same property, the company will only pay that part of any loss which is represented by the proportion that its policy bears to the total insurance granted under all the policies. In this connection it may happen that where a number of policies have been written in the name of the owner of the property, he may subsequently make one or more of these policies payable to a mortgagee under the usual Mortgage Clause, promising to protect the mortgagee's interest, regardless of any acts or neglect of the owner. When this is done, the question arises as to how a loss shall be apportioned among the several policies covering the property.

This subject was carefully discussed by the New York Court in the case of the Westchester Fire Insurance Company (73 N. Y., 141). Here the owner of the insured building had secured two policies in different companies, one for $4,000 in the Lycoming Company, and the other for $10,000 in the Westchester Company. The mortgagee had a mortgage on the premises for $14,000 and with the consent of the Company had his interest protected under a Mortgage Clause indorsed on the policy issued by the Westchester Company

[1] See the many legal citations on page 342 of Ostrander's "The Law of Fire Insurance."

[2] Am. Cent. Ins. Co. *vs.* Cowan, Tex. Civ. App., 34 S. W., 460.

and offering protection against the acts or neglect of the owner. Although the policies provided for the apportionment of the loss in case other insurance existed, the mortgage clause itself did not contain any agreement as to contribution. A loss of $9,000 occurred and the Lycoming Company, in accordance with the terms of its policy, which provided for the payment of any loss in the proportion that its policy bore to all the insurance on the property, promptly settled for $2,571.43, or four-fourteenths of the $9,000 loss, i.e., in the proportion that its policy of $4,000 bore to the total insurance of $14,000. The Westchester Company, whose policy also contained the same apportionment clause, insisted on paying only the balance of the loss, or ten-fourteenths. To this, however, the mortgagee objected on the ground that if this were permitted, his interest under the mortgage clause would suffer.

In deciding this case the court expressly declared that the mortgage clause, when indorsed on the policy, constituted an independent contract between the mortgagee and the Westchester Company. The mortgagee had a right to feel that his interest was protected under this independent agreement, especially since he had no interest in the Lycoming policy. The court therefore ordered payment of the loss to the mortgagee in the same manner as would have been the case if there had been no second policy.

In view of such rulings as the above, it is customary today, if the company wishes to retain the privilege of apportioning its loss among all the policies on a given property, to obviate all legal complications by inserting a "contribution clause" in the mortgage clause. In this case the clause is usually called the "Mortgage Clause with full Contribution." It reads the same as the clause already given, with the exception that there is added another paragraph to the effect that "in case of any other insurance upon the within described property, this company shall not be liable under

this policy for a greater proportion of any loss or damage sustained than the sum hereby insured bears to the whole amount of insurance on said property, issued to or held by any party or parties, having an insurable interest therein, whether as owner, mortgagee, or otherwise."

Although the wording of this "contribution clause" would seem to be sufficiently definite to preclude a misunderstanding, there have been conflicting decisions as to the effectiveness of this clause where the mortgagor, after protecting the mortgagee under a mortgage clause providing for full contribution, takes out subsequent insurance, of which the mortgagee may have no knowledge. In the case of Eddy *vs.* London Assurance Corporation (143 N. Y., 311) the owner of the property had taken out insurance for the protection of the mortgagee. The mortgage clause protected the mortgagee against the acts of the owner, and contained the contribution clause as quoted above. Subsequently, and for his sole benefit, and without the mortgagee's consent or knowledge, the owner procured other insurance which was not made payable to the mortgagee. Then a loss occurred, and the companies issuing the policies made payable to the mortgagee insisted on the right of paying only that portion of the loss represented by their pro-rata share of all the insurance on the property, even though taken out subsequent to the issuance of the mortgage clause and for the sole benefit of the owner. The court argued that in this particular case the "full contribution clause" in the mortgage clause was inconsistent with the other section in the same clause which protects the mortgagee against the acts of the owner, and that this last agreement must take precedence over the provision for contribution. Since the last policies were taken out by the owner for his own benefit and without the knowledge of the mortgagee, the court argued that "the act of obtaining this additional insurance was the act of the owner, and it was unknown to the mortgagee, and, of course, not

consented to by him. The additional insurance could by no possibility benefit him, as it was not upon any interest of his in the property. He could not, therefore, resort to any of these additional policies for his indemnity. It is not a case of contribution in any sense, but simply one on the insurer's theory of the diminution of their liability, caused by the act of the owner, and unknown, and with no possible corresponding benefits, to the mortgagee."[1] While legal text-book writers recognize the force of this reasoning,[2] it should be stated that in other cases the courts have sought to enforce this important provision of the policy as regards subsequent insurance, by declaring that the section of the mortgage clause protecting the mortgagee against the acts of the owner, is qualified by the agreement relating to contribution.[3]

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[1] Page 325.

[2] See Ostrander's "Law of Fire Insurance," p. 348.

[3] See Hartford Fire Insurance Co. *vs.* Williams, 11 C. C. A., 503; 63 Fed., 925, described by Ostrander on pp. 348, 349.

# CHAPTER V

## PARTIES TO THE CONTRACT—THE COMPANY AND ITS ORGANIZATION

*Types of Companies.*—The fire-insurance business of the country is transacted by three different classes of insurers. Named in the order of their importance they are, stock companies, mutual companies, and so-called Lloyd's organizations. Concerning mutual companies a further convenient classification may be made, viz., "county and town mutuals," "state mutuals," and "factory mutuals."

*State Statutes Governing the Incorporation, Organization, and Operation of Fire-Insurance Companies.*—The laws of the several States relating to the incorporation and organization of fire-insurance companies differ greatly in their details, but resemble each other in the principles involved and the objects to be attained. In outlining the method of incorporating and organizing companies, therefore, the law of Pennsylvania will be used as a basis, for aside from details such as numbers, amounts, and time, the law of this State will serve as a typical illustration of the underlying principles and methods elsewhere in use.

According to the law of Pennsylvania, fire and marine insurance companies may not do a life-insurance business. Any ten or more persons, who are citizens of the State, may associate themselves and form an incorporated company for the purpose of issuing firo and marine insurance. Such persons, according to the law, must associate themselves by articles of agreement in writing, which agreement must specify

(1) the name by which the corporation is to be known; (2) the class of insurance for which the company is to be constituted; (3) the plan or principle according to which the business is to be conducted, and the domicile of the company; (4) the amount of the capital stock, if any; and (5) the general object of the company, and the powers it proposes to have and exercise. The name of the company must clearly designate the object and purposes of the company, and in case the associated persons wish to form a mutual company, the word "mutual" must appear in the title.

The articles of agreement must next be acknowledged by the subscribers before some person who is empowered to receive acknowledgment of deeds, and must then be forwarded to the insurance commissioner. If the insurance commissioner approves of the same, the articles of agreement must next be submitted to the attorney-general for examination. If the attorney-general finds them to be in accordance with the law of the State, he certifies the same to the governor, with his approval indorsed thereon.

Following this, the subscribers to the articles of agreement choose a president, a secretary, a treasurer, and directors. In case the company is a joint stock company, the subscribers must next open books for the subscription of stock in the company, and such books must be kept open until the full amount of stock specified in the certificate is subscribed. Where a mutual company is to be organized, the subscribers to the articles of agreement must open books to receive applications for insurance until such applications have been obtained in sufficient number to comply with the law.

The capital stock of a joint stock fire-insurance company may not be divided into shares of less than $10 each. Ten per cent on each share must be paid in at the time of subscribing, the remaining 90 per cent may be paid in as the company may direct, but must, according to the law, be all

paid in within six months from the time of the subscription. When the capital stock specified in the articles of agreement has been subscribed for to the extent of one half, and 20 per cent of the same has been paid into the hands of the treasurer of the company, the officers and a majority of the directors must next under oath make a certificate to the Governor of the State, stating the number and par value of the shares of the company, the names and residences of the subscribers, the number of shares subscribed for by each, the amount paid in on each share, and the place where the same is deposited. In case the Governor approves the articles of agreement thus certified to him, he indorses his approval thereon and causes letters patent to issue, erecting the subscribers to the articles of agreement into a body corporate. But in no case is this body corporate to engage in the business of insurance until the stock has been fully paid in.

Besides carefully regulating the organization of fire and marine insurance companies, the statutory law of the several states seeks to make such companies safe, and protects the interests of property owners by carefully regulating the investment of all their funds. A joint stock fire or marine company in Pennsylvania must have a capital stock of not less than $100,000. A mutual company, on the other hand, may begin business when it has applications for $200,000 of insurance. A foreign joint stock company doing business in Pennsylvania must have a capital stock of $200,000. In Pennsylvania it is unlawful for any fire or fire-marine company, organized under the law of the State, to invest its capital otherwise "than in bonds and first mortgages on improved and unencumbered real estate, within the State of Pennsylvania, worth fifty per centum more than the sum loaned thereon, exclusive of buildings, unless such buildings are insured and the policy transferred to said company, or in ground rents, or bonds of the United States or of the State of Pennsylvania, or the bonds of any other State that may

be par at the time of the purchase thereof, or in the bonds of any county, city, or municipality in the State authorized to be issued by law and upon which no default in interest has been made, or in the first mortgage bonds of solvent railroad corporations upon which no default in interest has been made, and to lend the same, or any part thereof, on the security of such bonds or evidences of indebtedness, and to change and reinvest the same, as occasion may from time to time require; but any money over and above the capital stock of any such company may be invested in the securities above enumerated, or in the stock or other evidence of indebtedness of any solvent dividend-paying corporation created under the laws of this State or the United States, or loaned upon the pledge of the same, except their own stock; provided, that the current market value of such securities shall be at least twenty per centum more than the sum loaned thereon."

Not only do the states limit the investments of companies to certain special types of mortgages and securities, but the amount which any company may invest in any one given investment is also strictly limited. Thus, Pennsylvania provides:

1. That not more than one half of its capital stock is to be loaned by any company organized under the law of the State, on mortgages of real estate.

2. That not more than one tenth of its capital shall be invested in a single mortgage.

3. That no portion of the funds of the company are to be loaned on personal property.

4. That in case any investment or loan is made in a way not authorized by the law, the directors making or authorizing such loan shall be personally liable for any loss which may be occasioned by the act.

The laws of most of the states also carefully regulate the amount of real estate which a company may hold, since the past has shown a great deal of abuse in the excessive hold-

ing of such property. The law of Pennsylvania provides that no company organized in the State is to purchase, hold, or convey real estate, except for the purpose and in the manner described, viz., such real estate as shall be requisite for its convenient accommodation in the transaction of its business, or as shall have been mortgaged to it in good faith by way of security for a loan previously contracted or for money due; or as shall have been conveyed to it in satisfaction of debts previously contracted in its legitimate business or for money due; or which shall have been purchased at sales upon judgments, decrees, or mortgages. Furthermore, any real estate which may have been acquired and which is unnecessary for the accommodation of the company is to be sold and disposed of within five years after the company has acquired title thereto.

As a further protection the law provides that no fire or fire and marine insurance company is permitted to declare any dividend except from the profits which arise from its business. In estimating such profits, there is to be charged as a liability: "The capital stock of the company, together with the amount of the proposed dividend; one half of all the premiums received and receivable on undetermined fire risks, and the whole amount of premiums received or receivable on undetermined marine and inland navigation risks; all sums which are due the company on bonds and mortgages, bonds, stocks, and book accounts of which no part of the principal or interest thereon has been paid during the last calendar year, and for which foreclosure or suit has not been commenced for collection; all interest due or accrued and remaining unpaid, and all other debts or obligations of the company." It is also unlawful for any company organized in the State to pay dividends exceeding 10 per cent in any one year, unless its capital stock remains unimpaired, after charging as a liability, in addition to the items above enumerated, the entire amount of net premiums received and

receivable upon all risks undetermined at the time of making such dividend.

As regards the increase of capital stock by companies the law provides that "any fire or fire and marine insurance company may at any time make such increase if authorized to do so by a majority of the stockholders, which increase may be made by increasing the number of shares of stock or increasing the par value of the same and which may be paid in whole or in part out of the accumulated reserve of the company, in case the condition of the company warrants such allotment, or which may be sold as provided for in the law pertaining to the organization of fire insurance stock companies." In any case, however, the law is very precise on the point that new stock shall never be disposed of for less than par value. Moreover, before the company is authorized to increase its capital stock, it must file with the insurance commissioner a certificate setting forth the amount and the manner of the desired increase, and the proceedings of the stock owners authorizing the same. An examination of the securities composing the capital stock thus increased is also to be made by the insurance commissioner according to the requirements of the law for the organization of the companies. Watering of stock is thus clearly prohibited by the law of Pennsylvania as regards fire and marine insurance companies. The law again and again states that there shall be no issue of stock, except for value received.

The law of Pennsylvania also regulates the conversion of mutual companies into stock companies. Mutual fire-insurance companies may accumulate a reserve out of the profits of their cash business, and the law states that no mutual company shall be deemed insolvent or can be compelled by the insurance commissioner to make an assessment upon its policy-holders so long as its premium notes in hand and subject to assessment amount in gross to 3 per cent of the entire amount of the risks of the company. In case a mutual

fire-insurance company has accumulated $20,000 over and above all liabilities, including the cash reserve required by law on cash risks, and desires to create a capital stock, it may do so with the assent of two thirds in interest of its policy-holders at a meeting especially called for that purpose, such interest to be determined by the amount of premiums paid or premium notes given. Lastly, it is provided by the law of Pennsylvania that the General Assembly may revoke the charter of any insurance company if it deems fit, or if the concern has not started business within one year from the issuance of letters patent. It is provided, however, that such a revocation of the charter must be without injustice to the incorporators.

Besides carefully regulating the organization of companies, the character of their investments, the amount of dividends to be paid, and the issuance of new stock, the several states exercise supervisory power over the business affairs of the several companies, domestic and foreign. This supervisory power is exercised by the individual states, in view of the fact that insurance, having been declared by the courts not to be an article of commerce, does not come within the control of the federal government, and thus is relegated entirely to the legislative and supervisory powers of the individual states. But this phase of state control will be discussed in the chapter on the "State Regulation and Supervision of Fire Insurance."

*The Organization of Stock Companies.*—Judging by the total premiums received in the year 1908, the stock companies transacted 88 per cent of the fire insurance of the country, or over seven times as much as was written by all the other types of companies combined. As a rule, these companies operate over a widely extended territory, and of necessity require a large and intricate organization. Some companies seek business only in the larger cities. A widely distributed business, however, is desirable in order to make

the loss ratio from year to year as uniform as possible, and for this reason most companies extend their efforts into any territory which offers a profitable business.

The most important department of a stock company's organization, especially in point of size, is the underwriting department, or that which has to do with the solicitation and writing of policy contracts. The customary plan of the companies is to divide the territory within which they operate into districts, and place each under the supervision of a general agency. The offices of this agency are usually located in the larger cities, with the territory naturally tributary to the same constituting the agency's particular district. In this way it is hoped that the company can be brought into most intimate relations with the local agents and the insuring public. Some companies, however, see fit to adopt another plan, and to place at the head of each district one or more officers, who, in turn, are subject to the immediate supervision of the home office, with the hope of securing more uniform and economical action.

Of supreme importance in the underwriting business is the local agent, for it is through him that the company reaches the insuring public, and secures the business upon which it exists. It therefore behooves the companies to cultivate very cordial relations with the army of local agents, and to secure their efficient services. To this end special agents are employed who travel from place to place within their district, placing new agents, discontinuing unsuccessful ones, securing information concerning the company's risks, and, in general, exercising every means to maintain cordial relations with the local agents, and promote the interests of the company. The local agents usually reside in the smaller towns and cities, and solicit risks directly for the company. In the smaller towns where the business is not of sufficient volume to take all of the agent's time, it is generally carried on in conjunction with some other occupation,

such as real estate, banking, and the practice of law. In the larger cities the business is of sufficient volume to occupy all of the agent's time. But it must be understood that these local agencies do not necessarily represent a single company; they may have contractual relations as agents with a half dozen or more companies. They are often in business to write all the insurance of their locality, and if their customers have preferences as to the companies with which they wish their insurance placed, will endeavor to place the same as desired. Much of this kind of business, especially in large cities where business is congested and property values high, is placed by insurance brokers who act as middlemen between the insured and the company. Although a person may be both an agent and a broker, it is to be noted, that when acting in the capacity of a broker, he is regarded in most states as the agent of the insured and not of the company as regards all matters pertaining to the application for insurance and the writing of the policy.

In view of the many agents employed, and the many important matters which must be entrusted to their care, it is essential that the companies have a systematic way of checking up their work. To facilitate the writing of insurance, the local agents are supplied with blanks, unsigned policy forms, books of record, printed clauses, and other necessary equipment. Among these blank forms is what is called the "daily report" which has probably done as much as any other one thing to perfect the organization of the agency system. (See Fig. 2.) This report is filled out each day by the local agent and mailed to the department of the district in which he is located. It contains an abstract of all the policies written by the agent during the day, including in full all the written-in or descriptive portions of the policy. By this means the general agent or department head is enabled to keep in close touch with the work done by the local agents, and can much more readily rectify errors than could be done

under reports rendered at longer intervals. A monthly account of all the premiums received is also sent by the local agent to the department of his district. (See Fig. 8.)

But scarcely less important than the frequent reports of the agents are the so-called fire maps. These are prepared by experienced engineers, and companies often spend thousands of dollars in their careful preparation. They contain a minute and careful description of the fire district of a given locality, indicating the nature of all the risks, and showing the surrounding exposure hazard and fire protection facilities. By their aid the company or its general agents can at a glance obtain a fair description of any risk which any of their local agents may have insured.

Local agents are compensated by a commission of about 15 per cent of the premium income derived from the business they secure or renew. In return for this commission they are required to promote the interests of the company in every possible way. Their activity in nearly all cases is confined to the securing and filling out of applications, the writing or cancellation of policies, the collection of premiums, and the giving of service to the insured. The settlement and payment of losses, however, is generally delegated to special agents who travel from place to place, or where the companies are so large as to require the constant service of some one to adjust losses, special experts are employed for this purpose.

When the daily reports of the local agents arrive at the company's office, they are taken in hand by special examiners, and carefully reviewed with a view to discovering errors in the wording of the contracts or defects in the risks which may make it desirable to charge a higher premium, or reject it entirely. If such errors or defects are found the agent is instructed to cancel the policy or have it changed to meet the wishes of the company. These examiners require a careful training and extensive experience for their work. To judge

risks properly it is necessary that they should be conversant with the nature of different classes of property, with the importance of different classes of exposure hazard, and with the valuation of property. It is needless to say that in this respect the examiners are materially aided by the use of fire-maps.

After the daily reports have been passed upon and accepted by the examiners, they go to clerks and statisticians, who compile from them the reports which the company requires for its own information or which are necessary to comply with the statutory requirements for a detailed annual report. The financial accounts of the agents are also carefully checked by auditors and bookkeepers, and afterward sent to clerks for compiling.

Another division of the company's organization is the loss department. It is the business of this department to take charge of the settlement of all losses, and for this purpose, as already stated, special agents or adjusters are employed who try to effect a settlement of each loss as soon as it is reported to the general office. Careful accounts are kept by the department of all the losses and all information pertaining thereto, and the complete reports are then tabulated in the general office and compared with the premiums received. By this means a mass of statistical information is accumulated by which the company is able to measure the relative hazard involved in various classes of risks, and to obtain a knowledge of the cost of different risks, sufficiently accurate upon which to base a correct and just schedule of rates.

Located at the home office of the company and co-ordinating all the different departments, and with a general oversight over all, are the president and other officers of the company. Their duty is to map out and be responsible for the plan of campaign which the department managers and agents are expected to execute. They determine the general policy of the company and exercise general supervis-

ory powers. The board of directors, on the other hand, concerns itself chiefly with the banking and investment features of the business. The importance of fire-insurance investments may be appreciated when we reflect that the combined assets of the joint stock companies in the United States, exclusive of premium notes, in 1909 amounted to $570,911,883. The wise and conservative investment of these vast funds requires financial and business ability of a high order. But the insurance business, proper, requires technical skill and training, and for this reason is left to the care of officers and employees who are acquainted with its details.

*Local Mutuals.*—The county and town mutuals of the United States are exceeding numerous, approximately 1,500 being now in operation. In most instances they have developed as a protest against the high rates charged by the ordinary stock company. Their plan is to furnish insurance on the payment of a small cash premium, and in case losses exceed their income to depend for the balance upon some system of assessments. The policy-holder, in addition to the payment of the cash premium, is required to assume an extra liability in the form of a note. The liability of the members is usually fixed by the laws of the state or by the charter and by-laws of the company. Ordinarily the cash premium amounts to about one fourth of the premium charged by stock companies, and the note required from the policy-holder is for usually three or five times this sum. In case the company finds it necessary, this note is subject to call. The total liability of each policy-holder may, however, be much larger than the notes which he gave. Thus, according to agreement, the policy-holder may be liable for his share of all the liabilities of the company, or, as is most generally the case, for only a stipulated amount, i.e., a certain percentage of the amount of insurance carried, or a multiple of the amount of premium notes given.

In most instances local mutuals are organized by a group

of farmers or by property owners in villages and small cities to secure the lowest possible rates. The business is begun by issuing policies to the original members. After the officers have been elected, and the organization perfected, the business is usually entrusted to the care of a secretary, who in many instances, if the company is small, may also pursue some other vocation, such as law, banking, or storekeeping. In this way the expense item is reduced to a minimum. The valuation of the property to be insured, and the desirability of the applications is usually left to the decision of the board of directors or an executive committee.

Both the merits and demerits of local mutuals are found in the fact that they operate in restricted districts. Because of their local nature they are able to eliminate much of the moral hazard so frequently found in fire insurance. If the company is small, most of the members are acquaintances. It is easier therefore to avoid overvaluation, and it becomes exceedingly difficult for a dishonest man to obtain insurance. Moreover, a man usually does not bring the same loose moral code to bear on his actions when dealing with his neighbors and friends, as he does when dealing with an unknown corporation having headquarters in a distant locality.

But the writing of insurance in a restricted territory also constitutes an element of danger in that it loses sight of the inevitable law of average in insurance. So long as the fire loss record of the locality is sufficiently low or uniform, the mutuals may prosper, but upon the advent of a conflagration they too frequently break down. The number of mutuals that have gone insolvent is an exceedingly large one, and the cause in probably a majority of cases has been a conflagration or an unexpected series of large fires. The system of assessments provided for such contingencies, while ideal in theory, will in practice often utterly fail because of the difficulty or impossibility of collecting the assessments. Some of these companies have been conspicuously successful, and

are past the half-century mark of their existence, but it has been mainly due to their strict policy of insuring only a limited number of comparatively non-hazardous risks, or their luck in avoiding a conflagration or rapid series of fires.

Many of the state laws relating to local mutuals recognize the necessity of protecting their members against just such contingencies. Thus in some states, especially New York, they cannot operate in large cities. The New York, Chicago, and Boston conflagrations made bankrupt nearly all the local mutuals operating in those cities, and showed the wisdom of such legislation. Other states limit their activity to the insuring of non-hazardous risks, such as dwellings, farm buildings, and stores when situated in a given district. Many states provide that their business must be confined to a single town or county, or at most to a limited number of counties, such as three or five. In most of the states, before their organization is complete they must produce evidence of having procured applications for a considerable amount of insurance, usually from $50,000 to $200,000, and that a certain portion of the premiums on this amount of insurance, usually 25 per cent, has been advanced in cash.

*State Mutuals.*—Many attempts have been made, usually with unsuccessful results, to apply the mutual plan of fire insurance over one or more states. But these state mutuals, while retaining the objectionable features of the local mutuals—namely lack of assets, small volume of business, and assessments—also lack their elements of strength. The moral hazard is increased as the territory within which a mutual company does business increases. When such mutuals attempt to write insurance throughout an entire state they necessarily come into competition with the wealthier and more firmly established stock companies, and cannot secure business except at inadequate premiums. They also lack the business organization and the trained staff of experts possessed by the stock companies, and to secure business in

sections far removed from the home office, must depend upon agents for the soliciting of insurance and the selection of risks. The result is that the service is not of the best, and the supervision over the selection of risks is woefully inferior to that of the local companies.

As long as the company grows and policy-holders are not called upon to pay assessments, the management hears few complaints, and few members find occasion to trouble themselves about its affairs. The officers in too many instances, ambitiously strive to rapidly increase their business, and in doing so depend upon agents, whose interest it is to write as much insurance as possible. But in the course of time, the poor selection of risks begins to bear fruit. The low premiums are found woefully inadequate, and assessment after assessment must be collected from the policy-holders to meet the ever-increasing claims. It is then that the policy-holders begin to rebel against what they regard as unreasonable charges. As the claims against the company become more pressing, it in turn must resort to pressure, and even litigation, to collect the assessments, and then follows wholesale withdrawals and at last bankruptcy.

This has been the story of the great majority of state mutuals. By extending their activities over too large a territory personal supervision could not be exercised over the risks accepted, and powers delegated to employees were too often abused or inefficiently exercised. The rates were too low and the hazardous risks too many, and the result could not be other than failure. We are informed that at a recent date only two or three out of the seventy-four state mutuals in New York in 1853 were still in existence. To insure their greater safety a number of states have passed laws with special reference to their organization and operation. The number of applications for insurance which must be in hand before their organization is perfected is usually much larger than is required for local mutuals. The class of business

which they may accept is carefully limited in certain states while in others a limit is placed upon the amount of insurance which may be written on any one risk.

*The Factory Mutuals.*—There remains to be considered a class of mutuals, usually called the "factory mutuals," which by their conservative methods and careful management have attained an enviable reputation. Beginning with the Providence Manufacturers' Mutual Company, established by Zachariah Allen in 1835, this plan of underwriting has steadily developed until recently there were eighteen such companies in operation in Massachusetts and Rhode Island, as well as others in different sections of the country, writing over $1,000,000,000 of insurance. The success of these organizations, as contrasted with other mutuals, is chiefly to be attributed to their policy of preventing fire losses, rather than merely paying claims. In the words of Mr. Edward Atkinson, one of the pioneers in this type of insurance, "the only persons who can prevent loss by fire are the owners or occupants of the insured premises. Upon them rests the responsibility for heavy loss, if any occurs, in nearly every fire. All that the insurance company can do is to pay indemnity for loss, which, if large, in nine cases out of ten, is due to the lack of apparatus for preventing loss or to lack of care and order in the conduct of the work. It has always been the practice of the mutual companies and of late, with excellent results, the practice of the stock insurance companies, to instruct owners and occupants regarding their duties to their own property, and to keep them up to the mark by constant supervision and by refusing to grant contracts of indemnity to those who neglect their own duty." [1]

When factory owners came to a realization of the importance of reducing the fire waste, they first tried to co-operate

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[1] Quoted from Edward Atkinson's "The Prevention of Loss by Fire," Boston, 1900.

with the stock companies in reducing the fire loss, and consequently the premium charge, but the companies in the main assumed the attitude that they were insuring against fire losses, and not in business to prevent them. Then occurred the Chicago and Boston conflagrations, which made necessary an increase of from 50 to 60 per cent in the rates charged by the stock companies. Factory owners, finding such charges too burdensome, sought relief through efforts at mutual co-operation. Low cost insurance was to be obtained through an organization which would have for its object the twofold purpose of ascertaining and eliminating the causes of fire, and providing the means for extinguishing it, with a minimum of loss, when it should occur.

To this end the factory mutuals have made careful investigations into the different kinds of factory hazards, into methods of lighting and heating, and into the separation and isolation of dangerous processes. It was the factory mutuals which were most active in bringing about the introduction of automatic sprinkler systems, which, as will be explained later, have so radically revolutionized the methods of fire protection. These companies also set an extremely high standard for construction and fire-extinguishing appliances, with which factory owners must comply before being entitled to become members. As explained by Mr. Richard M. Bissell:[1]

"In their efforts to ascertain and eliminate the causes of fire, these companies have investigated and endeavored to safeguard all processes used in manufacture. They have investigated methods of illuminating, heating, and lubricating; have devised elaborate plans for the safe construction and arrangement of factories in order that the spread of fire may be retarded and that especially dangerous processes may be isolated; and, finally, have tested and

[1]Quoted from lecture on the "Organization of Companies," printed in the "Yale Lectures on Insurance, Fire, and Miscellaneous."

**applied the most modern and approved apparatus for extinguishing fires. Moreover, when a factory comes into their membership they not only see to it that in all respects its condition is brought up to their requirements, but by frequent inspection they secure the constant maintenance of such conditions. They are, indeed, hardly to be called insurance companies at all, but rather associations of manufacturers with experienced inspectors and engineers, whose work it is to eliminate the possibility of loss or serious damage by fire. The insurance feature only comes into play when, despite their precautions, a damage is incurred. It will be realized that, though the number of fires and the loss resulting therefrom has been very greatly reduced, by these methods a large expenditure is necessary to construct, arrange, and equip a factory in such a way as to bring it up to the standard of their requirements."**

The endeavors of factory mutuals along the lines suggested have reduced the fire waste among factories from proportions that were appalling to reasonable figures, and have brought about changes that the stock companies have been compelled in self-defense to adopt. The method of premium payments consists in charging a cash premium according to the nature of the hazard involved, and which is expected to be sufficient for the payment of all losses likely to happen; and then to provide for unforeseen contingencies by reserving the right to assess its members to the extent of say five times the cash premium. Unlike the experience of other mutuals, however, the factory mutuals have had no occasion to exercise the assessment feature. Since 1850, it is said that not a single New England factory mutual has found it necessary to collect an assessment. Instead, the cash premiums have much more than met all losses and expenses, and in nearly all instances have left a large surplus to be divided as dividends among the members.

*Lloyds Organizations.*—The third and least important class of organizations which do a fire-insurance business are the so-called Lloyds associations of one kind or another, named after the famous Lloyd's of London. These organiza-

tions have existed in large numbers since 1890, but in many instances were only short-lived. The total amount of insurance written was never very great, their proportion of the country's total fire insurance in the year 1908 amounting to only 2 per cent. Comparatively few of these so-called Lloyds can furnish reliable insurance, and while in some instances these organizations have been in business for a considerable period and have an honorable and successful record behind them, in too many instances the term Lloyd's has been used to imply the financial strength of the London organization, whereas in reality there is little financial responsibility back of the project, and its real purpose is the collection of premiums so long as these exceed the claims for losses.

Lloyds organizations may be defined as voluntary partnerships of groups of men, in which each member agrees to hold himself individually liable for the payment of losses up to a specified amount. In most cases, therefore, the value of the insurance contract depends upon the financial strength of the members in the partnership, though in some instances greater security is offered in the form of a guarantee fund which is available for the payment of losses. In too many cases, also, the policy contracts issued by these organizations contain a provision which protects the underwriters by providing that in case of a conflagration each partner can be held liable only to a certain fixed amount on all outstanding contracts, a provision which makes the insurance of very doubtful value to the owners of property in the congested sections of large cities. The organization of Lloyd's may be illustrated by the following statement of the "Assurance Lloyds of America" required by the insurance commissioner of New York and published in his annual report:

## ASSURANCE LLOYDS OF AMERICA

(Formed and commenced February 15, 1892.)

**Frank** M. Parker, Attorney. Charles E. Hill, Secretary.

*Underwriters Composing Association*

| Name and Address. | Liability Assumed. |
|---|---|
| **Victor** A. Harder, 128–132 White Street, New York City... | $5,000 |
| P. J. Carlin, 26 Court Street, Brooklyn, N. Y.............. | 5,000 |
| Charles H. Simmons, 110 Centre Street, New York City... | 5,000 |
| W. H. Loomis, Williamsport, Pa......................... | 5,000 |
| Charles T. Dotter, 30–32 Barclay Street, New York City... | 5,000 |
| Thomas Nelson, Jr., New Brunswick, N. J................. | 5,000 |
| Charles E. Hill, 141 Broadway, New York City............ | 5,000 |
| Frank M. Parker, 58 William Street, New York City...... | 5,000 |
| Augustine Banks, 34 New Street, New York City......... | 5,000 |
| J. Ross Valentine, M.D., Woodbridge, N. J................ | 5,000 |
| Edward G. Benedict, 68 Wall Street, New York City...... | 5,000 |
| C. L. Rickerson, Pier 43, North River, New York City.... | 5,000 |
| John J. Roberts, 1123 Broadway, New York City.......... | 5,000 |
| Colbert C. Brown, 1123 Broadway, New York City........ | 5,000 |
| Stephen M. Wright, Plainfield, N. J....................... | 5,000 |

(Here follows the financial statement.)

Owing partly to the fact that these organizations lack all the qualities which are regarded as constituting the financial strength of the stock fire-insurance companies, and partly to their very unsatisfactory record, many states have enacted special legislation for the protection of their patrons. In Pennsylvania these organizations are prohibited, and in some ten states they are required to make a cash deposit as security for the protection of policy-holders. Especially is this desirable, since the policies of these partnerships are insured by agents who represent all the partners and are not acquainted with the financial resources and business affairs of the several individuals. In the remaining states there is either no law at all governing this form of underwriting, or it is subject to the same requirements that apply to other insurance companies.

# CHAPTER VI

## AGENCY IN FIRE INSURANCE

One of the most vital subjects in fire insurance is that of agency. In this day when insurance is written almost exclusively by corporations, in most instances transacting business in many states, the agent is a necessary factor in the successful prosecution of the business. To govern his relations with the company there was to begin with the general law of agency. But there has since developed a large body of law dealing with insurance agents in particular, and it is from this law that we are able to comprehend the status of the fire-insurance agent.

As the term is generally understood, a fire-insurance agent is one who is engaged by a company to negotiate for and place contracts of insurance, to collect premiums therefor, and generally to aid in any manner in transacting the business of the company. There is a provision in the standard fire policy to the effect that "in any matter relating to this insurance, no person unless duly authorized in writing, shall be deemed the agent of this company." This provision makes a written contract the sole evidence of agency, and may be regarded as notice to the insured that it is not safe to have business dealings with an agent who cannot show his written authority.

Ordinarily the company gives its agents a written commission defining their authority. But a provision in the policy, such as just quoted, does not relieve the company of responsibility for the conduct of those who are in reality its agents but who may not have written authority. To hold

otherwise would enable the insurer at any time to avoid all responsibility for the misconduct or errors of its agents by simply sending them into the field without written authority. Agency is a fact depending on circumstances independent of this provision in the policy, and in numerous cases where the question has come up for adjudication, the courts have outlined the evidence that may be considered as proof of the fact and character of the agency. It may consist of an express contract between the principal and agent, or a recognition by the principal that a certain party is his agent. Again, the fact and character of the agency may be shown by the possession of papers such, for example, as policies executed in blank, or by the evidence of facts from which agency can be inferred as a matter of law. It is important to note, however, that the existence of the agency relationship cannot be presumed. It must be based on some real tangible evidence, and a person dealing with an agent is put on inquiry as to the extent of the agent's authority.

*Statutory Regulations of Fire-Insurance Agents.*—Formerly it was the practice of some companies to send their agents out without written agreements, or to provide in the policy that, as regards all matters pertaining to the application, the person soliciting the insurance is expressly agreed to be the agent of the insured. Then, when trouble arose through the occurrence of a loss, the company could avoid the claim by placing the responsibility for the agent's misconduct or error on the insured. The injustice of this mode of procedure is evident, and many states were not long in enacting statutes defining the powers and duties of agents, and the character of the policies they could write. Where such statutes exist they control the situation and overcome the evils formerly associated with the practice, already referred to, of inserting stipulations in the application or policy which would relieve the company from responsibility for the acts of its agents as interpreted by the courts.

In the majority of states the meaning of "insurance agent" has been defined by statute. The law of Massachusetts (section 93) will serve as an example, and resembles most of the other statutes on this subject. "A person not a duly licensed insurance broker," the law states, "who, for compensation, solicits insurance on behalf of any insurance company, or transmits for a person other than himself an application for or a policy of insurance to or from such company, or offers or assumes to act in the negotiation of such insurance, shall be deemed an insurance agent within the intent of this chapter, and shall thereby become liable to all of the duties, requirements, liabilities, and penalties to which an agent of such company is subject." Moreover the tendency of the state statutes is to make all agents general agents, except under certain stipulated conditions; and only a few states provide that one dealing with a soliciting fire-insurance agent is bound to ascertain the extent of his authority.

But the various states have not merely attempted to make soliciting agents specifically the agents of the company, but carefully supervise the operations of the agency force representing companies incorporated in other states. The law of Pennsylvania in this respect is probably as nearly typical as that of any other state, and will serve as an example. No person, according to the Pennsylvania Act, shall act as agent of a foreign company until that company has complied with all of the state's insurance laws; and any agent who shall assist in placing risks for a foreign company that has not complied with the law, shall be subject to a fine of from $100 to $1,000, and for the second offence to the same sum, or one year's imprisonment, or both. All foreign companies must certify to the insurance commissioner from time to time the names of their agents, and no agent can transact business for such company until he has received a certificate from the insurance commissioner stating that the company

has complied with the law, and that the person named has been appointed its agent. When doing business for a foreign company without such a certificate of authority, the agent is subject to a fine of $500, and is personally liable on all contracts made by him or through him on behalf of such company. Furthermore, any person representing or advertising himself as the agent of any fictitious or spurious company shall be subject to a fine of not more than $500, or imprisonment for not more than three years.

*The Character of Agency.*—According to the usual classification there are two classes of agents, namely "general" and "special" agents. Story, in his work on Agency, states the distinction between them to be as follows (No. 17): "A special agency properly exists when there is a delegation of authority to do a single act; and a general agency properly exists where there is a delegation to do all acts connected with a particular trade, business, or employment." Hence a general agent is one who is employed to transact all the business of his principal of a particular kind or in a particular place, while a special agent is one authorized to act only in a specific transaction. In most states the terms "general agent" and "special agent" are defined by statute or by court decision. Thus in Virginia (23 S. E. Rep., 744) a general agent is defined as "an agent authorized to accept risks, settle the terms of insurance, and to issue and renew policies of fire insurance." On the other hand, the company may appoint, we will say, a special agent with power to adjust losses. Here is an agent whose powers extend only to the fulfilment of a single transaction. In some states, like Wisconsin, the distinction between general and special agents has been eliminated by a statute which declares the agent to be the agent of the corporation to all intents and purposes.

When dealing with a general agent the insured may assume him to exercise all powers coming within the scope of

his apparent authority; but if the insured becomes cognizant of facts which would seem to indicate that the agent's authority is restricted, i.e., is special, it devolves upon him to ascertain the nature of the restrictions, and neglect to do this relieves the company from liability. In defining the powers of special agents, considerable difficulty arises, since the courts do not agree as to the powers which the insured may presume various classes of special agents to possess. In his summary of legal decisions defining the powers of special fire-insurance agents Elliott states: "There is considerable conflict of authority as to the powers of a soliciting agent who has actual authority merely to receive applications and forward them to the company for approval. It has been held that such an agent cannot bind the company by an oral contract of insurance, or for the renewal of a policy, or for additional insurance, or by his construction of the policy; nor can he consent to the assignment of the policy, or waive a condition therein. A mere collecting agent cannot bind the company by an agreement to waive any of the terms of the policy. So it has been held that an agent with authority to adjust a loss cannot waive a forfeiture of the policy, although he may waive the making of preliminary proofs of loss."[1]

The question as to whether a person may act as agent of both parties to the fire-insurance contract has been answered differently by the courts of the various states. One view is presented by the Supreme Court of Wisconsin (70 N. W. Rep., 84, and 48 Wis., 420), and is to the effect that the state statute defining insurance agents does not prevent such an agent from acting as the agent of the insured in certain cases. In the case last cited (Northrup *vs.* Germania Fire Insurance Co.) the agent of the company also had charge of the property as regards the collection of rents, the payment of taxes,

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[1] "Elliott on Insurance," pp. 133, 134.

and the placing of insurance. The court held that the dual relationship of the agent was not illegal, because he was not required to assume incompatible duties. Another view, however, is taken by the courts of Colorado[1] and Georgia,[2] the first deciding that either party to the contract can avoid a policy of insurance negotiated by one who acted as agent for both the company and the insured, unless both parties were aware of the agent's dual relationship and ratified the same; and the second holding that the company must give its consent before its agent can also be the agent of the applicant for insurance. It should also be stated here as a general rule, that if a company revokes its agent's authority and does not notify the insured of such revocation, the subsequent acts of such agent will bind the company.

*Brokers Distinguished from Agents.*—The statutory law of most of the states makes a distinction between insurance brokers and insurance agents. In section 93 (Chapter 214, Statute of 1887) of the Massachusetts law, which is illustrative of the law in many states, a broker is defined as constituting any person "who, for compensation, not being the appointed agent or officer of the company in which such insurance or reinsurance is effected, acts or aids in any manner in negotiating contracts of insurance or reinsurance for a person other than himself. Most of the laws provide that no person shall act as an insurance broker until he has procured from the insurance commissioner a certificate of authority so to act, and has paid a license fee varying in the different states from a minimum of $10 to a maximum of $200. Such certificate of authority authorizes the broker named therein to negotiate contracts of insurance, place risks, or effect insurance, with any company established in the state, or its agents, and with the agents of any foreign

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[1] British America Assurance Co. *vs.* Cooper, 6 Colo. App., 25.
[2] Rauspeck *vs.* Patillo, 104 Ga. Rep., 772.

company duly authorized to transact business within the state. In a number of states such as New York, New Jersey, and North Carolina, laws have also been enacted governing the brokerage of excess lines of insurance. The law provides that the insurance commissioner may issue a license to citizens of the state permitting them to act as agents to procure policies of fire insurance from corporations or associations which are not authorized to transact business in the state, provided both the insured and licensee execute affidavits, to be filed with the insurance department, that sufficient insurance cannot be obtained in companies legally authorized to transact business in the state.

There has always been considerable disagreement in the various states in regard to the legal position which the insurance broker bears to the insured. In some states, for example, Indiana, the courts have declared (Ins. Co. *vs.* Hartwell, 123 Ind., 177) the broker to be the agent of the party who pays him for his services, regardless of the source of employment. As has been pointed out, this rule will always involve uncertainty until the courts fix the ownership of the fund from which the broker is compensated. According to other states the broker is considered to represent the insurance company as its agent as regards the delivery of the policy and the payment of the premium, but is the agent of the insured in all other matters pertaining to the insurance. Some states have also seen fit, no doubt for the benefit of the insured, to enact special statutes making the broker the agent of the insurance company in certain cases. In the majority of states, however, the broker is regarded as the agent of the insured in all matters, and is declared by a statutory law to represent the insured and not to be the agent of the company.

The importance of this rule to the insured can scarcely be overemphasized. When transacting business with a broker in these states it is well for the insured to bear in mind that

the broker is his agent, and that consequently the act or knowledge of the broker is his act or knowledge. Many important illustrations of this principle can be found in the cases of our state supreme courts. In Sellers *vs.* Commercial Fire Insurance Co. (Alabama, 16 Southern Rep., 798) the court held, "that the broker was the agent of the insured and not of the company, and that any misrepresentations in the application, due to an error of the broker, which were made warranties, avoided the policy;" and in Pennsylvania we find (Hamblet *vs.* City Insurance Co., U. S. D. C., 19 Pittsburg Legal Journal, 51) that "a broker who is employed to procure insurance must be regarded in such matter as the agent of those employing him, and his concealment from the company of any material fact, if such concealment be wilful or intentional, is the concealment of his employer." Another representative case, illustrating the importance of the distinction between insurance agents and brokers, is that of The Pottsville Mutual Fire Insurance Co. *vs.* Minnequa Springs Implement Co. (100 Pa. St., 137). According to the facts of this case, the policy required the payment of the actual cash premium to the company before becoming valid. "A," the property owner, applied to "B," a broker, for insurance, and "B" arranged to procure the policy through "C," another broker. "C," in turn, found it convenient to apply to broker "D" for the insurance, and "D" obtained the policy from an authorized agent of the company. The policy when received by "D" was delivered to "A" through the hands respectively of "C" and "B," who, it will be remembered were brokers. When "A" received the policy, he paid the premium to "B," who, in turn, paid it to "C." During the interval that "C" held the premium, and before passing it on, the property was destroyed. The company refused to pay the claim on the ground that there had been no payment of the premium, since "C," a broker, was the agent for all purposes of the insured and not the company.

The court held that since "B," "C," and "D" were all brokers and the agents of "A," payment of the premium to any of these parties was not payment to the company, and a loss having occurred, the company could not be held liable.

It should be stated, however, that the courts have decided differently in cases like the above example, where it can be shown that arrangements have been made whereby the broker makes a periodical settlement with the company for premiums collected. In the case of Riley *vs.* Commonwealth Mutual Fire Insurance Co. (110 Pa. St., 144), "A" requested a broker "X" to procure for him a fire policy, and "X" obtained the same from "C," who was the agent of the company. "X" received the premium from "A," but retained it, expecting to keep the same until the end of the month when the usual monthly settlement between himself and the company was to be made. While thus retaining the premium a loss occurred, whereupon "X" tendered the premium to "C," who refused to take it. Although the policy contained a provision, just as in the previous case, that there should be no binding contract until the actual cash premium had been paid to the company, the court held that, owing to the relation of debtor and creditor which existed between the broker and the agent of the company, the policy was valid and the agent obliged to accept the premium. So also in the State of New York (Bini *vs.* Smith, N. Y. S. C., Aff. Div., 55 N. Y. Sup., 842) it was decided that where a broker was authorized to collect premiums on policies, "and had a running account with its general manager, in which the premium was charged, and gave the general manager a note for the balance due on his account, the broker was the company's agent, and the company is liable for a loss though the premium was never accounted for."

*The Powers of the Agent.*—The general rule relating to the powers of agents is stated by Elliott as follows: "An agent may bind his principal when acting within the scope

of his authority, and his power will be determined not alone by the actual but also by the apparent or ostensible authority."[1] A general agent's powers are coextensive with those of his principal within the limit of the particular business or territory in which such general agent operates. A special agent's powers extend to anything necessary for the accomplishment of the particular transaction in which he is engaged. From the standpoint of the insured, general powers may be assumed if the agent has apparent authority, but the assumption, as we have seen, must be based on substantial evidence.

Since the acts of the general agent are the acts of the principal, it follows that he can waive conditions in the policy and make special arrangements with the insured, subject, however, always to any legal limitations that may have been placed upon his authority, and which are known to the insured. In other words, the company is bound by the acts of its agent, if acting within the scope of his apparent authority. Wolff defines the power of waiver by the agent in the following manner:

> "A provision in a fire insurance policy that a waiver of its conditions must be in writing attached to or indorsed on the policy by an officer, agent, or representative of the company" (such a provision is found in the standard fire policy) "may be waived by the company acting through such officer, agent, or representative. As between the company and insured, the company is bound by the acts of its general, local, or sub-agents, regardless of what they are called, if the insured, influenced by the manner in which the company holds him out to the world, is justified in accepting them as, and believing them to be, clothed with such authority. An insurance company may limit the authority of its agents, but such limitations must be so indicated to the insured that he, as a prudent man, will rely at his peril on any act in excess of such authority."[2]

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[1] Elliott, p. 137.

[2] Wolff's "Law of Insurance Agency," p. 75.

The following examples are selected from Wolff as illustrations of the many instances that may arise where an agent can bind his company by exercising his power of waiving conditions of the policy:[1]

"If the agent knows warranties by the insured are false, and yet issues the policy, the warranties are waived" (p. 77).

"By retaining the premium with knowledge of a forfeiture of a policy condition, such forfeiture is waived" (p. 77).

"By a prior agreement with the insured, an agent can waive conditions of the policy as to sole ownership" (p. 77).

"An agent may consent to prior or subsequent insurance, although the policy forbids it" (p. 78).

"An agent may, by indorsement on the policy, bind the company to an assignment of interest" (p. 79).

"An agent can waive a condition against incumbrances by an indorsement on the policy" (p. 79).

"An agent can by written indorsement permit the removal of insured goods to another location" (p. 80).

"He may consent to a vacancy and insure property he knows to be vacant" (p. 81).

"He may extend credit for a longer time than the company has authorized" (pp. 81 and 82).

"If the agent has authority to adjust a loss he may waive proof of loss" (p. 145), "and can bind the company on an admission of liability" (p. 146).

"By his statements he can waive the company's right to object to proof of loss, or take advantage of the delay in submitting them" (p. 147).

"By his admissions he can bind the company when adjusting a loss" (p. 148), "or prevent the company from suing" (p. 148).

"Delivery of proof of loss to the agent of a company is delivery to the company" (p. 151).

"The company is bound by its acceptance of a compromise settlement of a loss made by its agent" (p. 152).

In all cases, however, if the company wishes to protect itself, it can limit the powers of the agent in any manner thought desirable. Such restrictions on the agent's author-

[1] See the many legal case citations for each of these examples.

ity will prove effective in all cases where the insured had knowledge of the same. If the limitations are contained in the application which the insured signs, the courts have generally regarded them as binding against the applicant. But where the limitations are inserted in the policy considerable difference of opinion exists. In some states the courts have refused to uphold provisions in the policy which limit the authority of the agent, whereas others regard them as effective against the insured who has agreed to be bound by the terms of the contract. The weight of authority, however, is to the effect that policy provisions which define the future powers of the agent should be enforced against the insured in matters which arise subsequent to the issuance of the policy. It is essential to bear in mind that, as regards an agent's powers, a distinction should be made between those acts which relate to the solicitation and writing of the policy, and those which pertain to future events, such as the giving of permits and the waiving of policy conditions. The company, however, is not permitted to limit its powers to act through its officers and general agents by inserting a provision in the policy to this effect. Although the standard fire policy provides that "no officer, agent, or other representative of this company shall have power to waive any provision or condition of this policy except such as by the terms of this policy may be the subject of agreement indorsed hereon or added hereto, and as to such provisions and conditions no officer, agent, or representative shall have . . . such power or be deemed or held to have waived such provisions or conditions unless such waiver, if any, shall be written upon or attached hereto," the courts have decided that the company can waive this provision like any other, and that the general agent has power to do what the company can do. In New York (Weed *vs.* London, etc., Insurance Co., 116 N. Y., 117) it was decided that "notwithstanding the provision of the policy that anything less than a specific

agreement clearly expressed and indorsed on the policy should not be considered as a waiver of any printed or written condition therein, the court recognized and affirmed the law, as settled in the state, that such condition can be dispensed with by the company or its general agent by oral consent as well as by writing."

Agents in the course of their daily business are frequently asked to express opinions on the meaning of policy provisions and other matters, and it is of the utmost importance that definite relations should exist between the company and its agents as regards the expression of such opinions. What, then, is the legal effect of the agent's opinion? The general rule is that no legal effect can be given to such opinions in case, for example, they result in misleading the insured as to the meaning of any policy provision. This view is based on the theory that an agent's opinion as to the meaning of any section of the contract does not create new or change old obligations. A case in point is that of the Laclede Fire Brick Mfg. Co. *vs.* The Hartford Steam Boiler Inspection and Insurance Co. (9 C. C. A. 1; 60 Fed. 351). After taking a policy the insured later asked that insurance be granted on several more boilers. The agent and inspector of the company several times expressed himself to the effect that the new boilers were covered by the original policy. When a loss occurred the company denied the claim, and the court held that despite the agent's statement no modification of the insurance had been made, and that no new contract existed.

*Liability of Agents for Misconduct to the Principal.*—The relation of the agent to his employer is such that he must never further his own personal interests by disobeying or exceeding his instructions. Any misconduct of the agent of either the insured or insurer makes him personally liable to his principal for the damage occasioned. Among the many legal text-books announcing this principle we may

quote from Story on Agency, section 217: "Whenever an agent violates his duties or obligations to his principal, whether it be by exceeding his authority or by mere negligence or omission in the proper functions of his agency or in any other manner, and any loss or damage thereby falls on the principal, he is responsible therefor, and bound to make full indemnity."

As illustrations of this rule, a number of instances may be cited, where the agent is liable to the insured. Thus if he represents an unincorporated company he will be liable to the insured for any loss that may occur, for in the absence of any responsible principal from whom indemnity can be obtained, the law presumes that he wrote the policy on his own responsibility and account, and intended by his act to hold himself responsible. If the agent places insurance for his employer in an insolvent company he is likewise liable to him for any loss that may occur,[1] and if engaged for the purpose of keeping his employer's property insured, he becomes liable if he does not protect the same as agreed.[2]

When representing the company, the agent, as we have seen, is bound to act in conformity with the definite instructions given to him by his principal, and no custom or usage can overcome the same.[3] Failure to obey his principal's orders literally makes him responsible for any losses that may result, unless the execution of such orders is prevented by an unavoidable accident or he is required to perform an act which is illegal or immoral. If ordered by the company to cancel a policy, neglect to obey the order renders the agent liable for the amount of the loss, and this rule is not waived even though he gives instructions to a broker who placed the insurance with him to have the policy cancelled. In the same way, if ordered to make a reduction

[1] Hurrell *vs.* Ballard, 3 Fost. F., 445.
[2] Thomas *vs.* Funkhouser, 91 Ga., 478.
[3] Osborne *vs.* Rider, 62 Wis., 235.

in the amount of the policy, failure to comply will make the agent liable. Furthermore, in case he cancels policies with a view to subordinating his principal's interest to his own selfish gain, the agent is liable to the company for the premiums involved.[1] Especially is this true when the agent resorts to the practice of "twisting," i.e., of inducing policyholders, when his agency with a company terminates, to cancel their policies with that company, and have him rewrite the same in another company which he now represents. Where an agent is guilty of this practice, he is liable to the company which originally wrote the policies for the commission on the unearned premium.[2] An agent must also account to his principal for all money collected in the manner agreed upon.

*Knowledge of Agent the Knowledge of the Company.*—Unless the agent's authority is restricted by the company, and the restrictions are known to the insured, it is a well-recognized principle that the knowledge of the agent is the knowledge of the company. The principle is well summarized by Wolff in the following words: "Before he issues a policy, the power and authority of a local and soliciting agent of a fire-insurance company are coextensive with the business with which he has been entrusted, and his positive knowledge of material facts, and his acts and declarations within the scope of his employment are binding on his principal unless such principal restricts his authority, and such restrictions are known to the other party at the time of the transaction.[3]" But a distinction must here be made between the time preceding the issuance of the policy and the time following. It is a generally accepted rule that knowledge

[1] Phœnix Insurance Co. *vs.* Pratt, 36 Minn., 409; Northern Assurance Co. *vs.* Hamilton, 50 Nebr., 248.

[2] American Steam Boiler Co. *vs.* Anderson *et al.*, 6 N. Y., Suppl., 507.

[3] Wolff's "Law of Insurance Agency," pp. 121, 122.

concerning matters pertaining to the insurance which comes to the agent subsequent to the issuance of the policy will not be considered as the company's knowledge, the company being held responsible only for the knowledge of the agent at and preceding the issuance of the policy.

The many important instances where the courts have considered the agent's knowledge the knowledge of the company, makes an understanding of this particular phase of the law of insurance agency especially desirable. Thus in case no misrepresentations are made by the insured as to his interest in the property, any incorrect statement of the same in the policy by the agent on his own knowledge prevents the company from claiming that the insured did not truly state his insurable interest. If the agent has knowledge of the uses to which the insured premises are applied, this will prevent the company from declaring a forfeiture of the policy because of provisions in the policy prohibiting such uses. An agent's knowledge will also bind the company and prevent a forfeiture of the policy, regardless of its provisions to the contrary, if he has knowledge of the true condition of the insured's title to the property, or if he knows that there has been a transfer of the title or foreclosure proceedings have been commenced against the property prior to the issuance of the policy. Similarly, if the agent knows when issuing the policy that the insured's ownership was not sole and unconditional, or that the personal property was mortgaged or the realty incumbered, this knowledge will operate as a waiver of the conditions in the policy which avoid it for any of these reasons. In all these instances, however, it is essential that the insured did not actually misrepresent the facts when applying for the insurance.

If, when writing the policy, an agent has knowledge of another policy to be obtained, the courts have declared that this knowledge will waive the provision in the policy providing against other insurance without the consent of the com-

pany. Or if the agent has been notified by the insured that other insurance has been taken, and he raises no objection, the company cannot claim the policy forfeited because of the "other insurance" clause. Knowledge on the part of the agent of prior insurance will also protect the insured against a forfeiture, even though the policy stipulates that the company must give its consent to such other insurance.

The company is also held responsible for any errors of the agent, which he may commit in making indorsements on the policy, when the correct information was given him by the insured. When the premises were vacant at the time of the issuance of the policy, and the agent has knowledge of this fact, such knowledge will constitute a waiver of the vacancy clause in the policy. An agent's statement to the insured that a requested vacancy permit had been indorsed on the policy will prevent a forfeiture of the policy in case this has not been done, because the agent's statement is considered the statement of the company and the insured had a right to rely upon the same. Nor is a fire-insurance policy avoided by any increase in the hazard, although the policy so declares, if such increase is known to the local agent of the company.

The foregoing illustrations are a few of the many important instances where the knowledge of the agent is considered the knowledge of the company.[1] It will be observed that in nearly all cases the company's responsibility is limited to the acts or knowledge of the agent at or before the time when the policy was issued. No liability, however, rests on the company for any knowledge of the agent acquired in the course of employment not connected with such agency. Nor is knowledge of a broker to be considered the knowledge of the company. In the case of East Texas Fire Insurance Co.

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[1] For a detailed enumeration of examples and citation of cases see Wolff's "Law of Insurance Agency."

*vs.* Brown, 82 Tex., 631, it was held that "the knowledge of a broker, acquired in effecting insurance, is not the knowledge of the company that issued the policy, even though the risk was secured at the request of such company."

*Liability of the Company for the Acts or Knowledge of Sub-Agents and Clerks.*—While there is not a unanimity in all the decisions, the weight of authority is to the effect that the insurer is liable not only for the acts of its agents, but also for the acts and knowledge of the sub-agents and employees to whom it has delegated authority. In insurance it is a common practice, and is frequently found necessary, for the agents to employ others to assist them in their work, and having delegated their authority to them, the courts have regarded it as "just and reasonable that insurance companies should be held responsible not only for acts of their agents, but also for the acts of the agents employed within the scope of their agents' authority." While it may be argued that the company has not authorized its agents to delegate their authority to others, and that it would therefore be an unreasonable extension of the company's liability, it must be remembered that agents are employed by the companies in accordance with the usages and necessities of the business. While the company may not expressly have authorized its agents to delegate their authority, it did know or should have known that according to the general usage or necessity of the business, these agents would be obliged to employ others to assist them in their work.

Wolff, in his "Law of Insurance Agency," states the principle as follows: "A clerk who is authorized by the agent of a fire-insurance company to solicit insurance, is sufficiently the agent of the company so that notice to him of a material fact connected with the risk is notice to the company."[1]

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[1] Wolff's "Law of Insurance Agency," p. 135. Also see many legal citations mentioned on this page.

Again he states, as decided by the Supreme Courts of Illinois and New York,[1] "a clerk of an insurance agent, who keeps his books, conducts his correspondence, receives and collects premiums, solicits business and fills in blank policies (without signing them) may bind the company by consenting to the premises insured being vacant."

[1] 127 Ill., 365; 51 N. Y., 117.

# CHAPTER VII

## THE DESCRIPTION OF THE PROPERTY INSURED

THREE sections of the Standard fire policy refer to the description of the property which is covered by the policy. The first of these refers to the description of the nature and location of the property; the second relates to the effect upon the validity of the policy of concealment or misrepresentation in any matter pertaining to the insurance; and the third provides that any application, plan, or description of the property shall be a warranty and constitute a part of the contract.

1. With reference to the description of the character and location of the risk, the standard policy provides that the company insures "to an amount not exceeding $.....to the following described property while located and contained as described herein, and not elsewhere, to wit;" and then follows a blank space of considerable size in which may be written the description of the property insured. Nothing could seem more definite than the above statement, and one would anticipate but little controversy as to its proper meaning. The importance in fire insurance of the location of the property is well recognized, and it is a well-established doctrine that an insurance policy covering property in a certain specified place will not follow the property on its removal to a different location. Yet some courts have qualified this general doctrine, and, while admitting that the location of the property is an essential feature in the contract, hold that it must always be viewed with reference to the character of the property, the primary object for which insurance was

taken, and the reasonable use to which the property must necessarily be put. Thus where a policy insures a stock of goods as contained in a specified place and "nowhere else to wit," the policy will be held to cover this property only while located in the described building, and the insurance will not follow the property if removed to another locality. If, on the contrary, however, the property is of such a character that it must necessarily be moved from place to place, the presumption is made in many states that the exact location of the property is a matter of subordinate importance which must be viewed in the light of existing circumstances.

As an instance, where the section of the policy concerning the location of the property was interpreted leniently with reference to the character of the property, we might mention the case of McClure *vs.* Girard Fire and Marine Insurance Company, 43 Iowa, 349. The property destroyed was a vehicle which was insured along with other property described in the policy as contained in a certain building and "nowhere else to wit." The vehicle in question, however, had been removed to a carriage shop for repairs, and while in this new location was destroyed by fire. The company denied the claim on the ground that the property had been moved, and that its removal had increased the risk because the danger of fire to property while contained in the repair shop was greater than in the building specified in the policy. The court, however, viewed the policy with reference to the character of the property and rendered a decision favorable to the insured in the following words: "It may be conceded that the situation of the property is mentioned in the policy as a fact affecting the risk. The words describing the situation must be regarded as a warranty, not only that the property was contained in the building but would continue so, and if at the time of the loss the carriage was not contained in the building within the meaning of the policy we do not see how the plaintiff can recover. . . . But what is meant by the

term? The material fact was that the carriage when not in use was kept in the building described as its ordinary place of deposit. The words which are used must be construed with reference to the property to which they applied. Carriages which are kept for sale and are insured as contained in a single warehouse could not be removed to a different warehouse without voiding the policy. There is nothing in the nature of the property to indicate that they will be removed and the insurance is not made with reference to such facts. But where a person procures a policy (as in this case) on horses, harnesses, and carriages as contained in a certain place, the presumption must be that they are in use and that the policy is issued with reference to such use. . . . Each policy must be construed according to the intention of the parties as manifested by all its terms. We are of the opinion, therefore, that while the words 'contained in a specific place' are words relating to the risk and constituted a warrant that the carriage would continue to be contained in the place designated, they mean only that the specific place described was their place of deposit when not absent therefrom for temporary purposes incident to the ordinary uses and employment of the property.''

As representing the other view may be mentioned the case of Village of L'Anse *vs.* Fire Association of Philadelphia, 119 Mich., 427. Here the village had insured all its fire-extinguishing apparatus under a standard fire policy. The property was insured in a given building and ''not elsewhere to wit.'' While being used to extinguish a fire the apparatus was completely destroyed, and the company denied the claim on the ground that the property according to the terms of the policy was covered only while located in the specified building. In deciding the case the court took a view opposite to that given by the Iowa court, and held that the words of the standard fire policy are unambiguous and not susceptible to a construction other than that which the words them-

selves impart. In other words, the court declined to take into account the fact that the property insured would temporarily be removed from its usual place of location in the course of its ordinary employment. Since the policy expressly covered the property only while in a particular building, it was held not to cover it when situated in any other location.

2. Lines 7 to 10 of the standard fire policy provide that: "This entire policy shall be void if the insured has concealed or misrepresented, in writing or otherwise, any material fact or circumstances concerning this insurance or the subject thereof; or if the interest of the insured in the property be not truly stated herein; or in case of any fraud or false swearing by the insured touching any matter relating to this insurance or the subject thereof, whether before or after a loss." Following this clause many other acts are mentioned which, unless provided for by agreement indorsed on the policy, will make the entire policy void. This section of the policy draws attention to the importance of furnishing the company with a correct statement of the description of the property either before or after a loss as well as a true statement of the insurable interest which the insured possesses in the property covered. As stated before, the fire-insurance contract must be viewed strictly as a personal contract which insures the owner of the property rather than the property itself. In fact there is no contract in which one party, the company, is so absolutely at the mercy of the other party as in fire insurance. For this reason the *entire policy* is justly held to be null and void in the case of misrepresentation or fraud.

Aside from this phase, however, the above clauses also direct attention to an important doctrine in fire insurance, usually designated the doctrine of the "entirety or inseparability of the contract." This doctrine applies in cases where more than one item of property is insured in the same policy. It is a very frequent occurrence that several items of property, such as several buildings, or the building and the stock of

goods within the building, are covered by the same policy. Where this is done, it has been held by the courts in the great majority of states that if the premium is paid in one sum the policy is to be considered as a unit and inseparable. This means that if a policy covering several items of property is violated as regards one of the items the policy will also become null and void as regards all the other items.

Numerous cases may be cited to illustrate the operation of this doctrine. One of the most important cases upholding the doctrine is that of McQueeny *vs.* Phœnix Insurance Company, 52 Arkansas, 257. According to the facts of this case the Phœnix Insurance Company insured two buildings under one policy, the policy containing a clause that if during the term of the insurance the above mentioned premises should become vacant or unoccupied, except as specifically agreed in writing upon the policy, then the policy shall cease during the period of vacancy or unoccupancy. At the time of the fire one of the dwellings was occupied, whereas in the other no one was living. Both properties were destroyed. The insurance company acknowledged its liability on the building that was inhabited and paid the loss, but claimed that the policy was void as regarded the vacated building. The insured, on the other hand, took advantage of the doctrine of the entirety of the contract and maintained that the two dwellings were insured under one indivisible contract, and that if the company acknowledged liability for the loss of one of the buildings it therefore was also liable for the loss of the other. This was the view taken by the court, and, in all probability, if the company had refused payment on either of the buildings, it would have been absolved by virtue of this same doctrine from liability on both risks.

Again, in the case of Gottsman *vs.* Pennsylvania Insurance Company, 56 Pa., 210, the policy covered two items of property, namely, a building and the personalty within the building. The policy contained a provision to the effect that

the company must be informed of certain incumbrances on the property, and it happened that in this connection the owner of the property had incumbrances on the building unknown to the company, but had not violated the policy with reference to the personalty insured. Both items were destroyed, and the insured, while admitting that he was not entitled to any indemnity for the building, attempted to collect the value of the personalty, arguing that he had not violated the policy with reference to this item. The court, however, did not allow the claim, holding that the contract was a unit, and that if violated in respect to any one item it was also violated as regards all the others.

In recent years certain courts have emphasized the view that a policy of insurance should be interpreted with reference to the purpose of the contract. Thus, in the case of the Connecticut Fire Insurance Company *vs.* Tilley, 88 Va., 1024, the court did not permit the application of this doctrine. In this instance the policy covered sixteen tenement houses and contained the usual vacancy clause. At the time of the fire eight of the houses were vacant and eight were occupied. The company claimed that, since the policy was inseparable, and since its provisions had been violated as regards some of the items insured, there was a forfeiture of the policy as to all the items. The court thought differently however, and held that the indemnity was good as to those buildings which were occupied and void as to the others. "We think," said the court, "this decision substantially just to both parties, and in nowise conflicting with legal rules. There were sixteen different and distinct risks, all written as a matter of convenience in one policy. Under any other ruling the court would have been obliged to settle one way or the other, and this would have involved a gross injustice to one party or the other, and in no way have given legal effect to the well-understood intention of the fire insurance contract."

In criticising the many court cases which have been rendered with reference to the doctrine of the entirety of the contract, it seems that the nature of the property should be taken into consideration. If the several items covered under one policy are widely separated and not related to one another in such a way as to be lost in a single fire, it would seem fair to both insured and insurer that the doctrine of the inseparability of the contract should not apply. On the contrary, if the several items of the property insured, such as a building and the contents within the building, are so related to one another that a fire in the one item will imply danger to the other, then it is clear that public policy should require the enforcement of the doctrine of the entirety of the contract. Not to do so would greatly increase the moral hazard. An example may serve to illustrate the application of the doctrine of the entirety of the contract in instances of this kind. Thus let us assume that a person owns a building and stock within the building worth $10,000 each, and both are insured under the same policy for $20,000. Let us now suppose that the owner procures additional insurance on the contents of the building for an amount greater than its value and without informing the first insurer. It will be apparent that by allowing the owner to thus increase the insurance on his personalty an increased moral hazard attaches to the entire property, because there is an inherent connection between the contents of the building and the building itself; if one catches fire the other is also likely to burn. Now if the policy is held to be divisible, and that part which relates to the building could not be forfeited by disobeying the terms of the policy as regards the personalty, the owner of the property might easily secure overinsurance on the personalty with a view to running the risk of not being discovered, and feeling that even if he were discovered he would still be sure of his indemnity on the other item. This would imply a wrong to the insurance company, since it would be deprived

of the security which had been especially provided for by the terms of the policy.

3. Lastly, the standard fire policy provides (lines 45 and 46) that "if an application, survey, plan, or description of property be referred to in this policy, it shall be a part of this contract and a warranty by the insured." To give added force to the information furnished in any application, survey, plan, or description of the property, and to protect the company as fully as possible against fraud, fire-insurance policies usually declare all such information to have the effect of a warranty. This brings us to a distinction between "representations" and "warranties." In probably no business is this distinction of such a vital importance as in insurance along all lines. Again and again the life-insurance policy calls the attention of the insured, usually in large print, to the fact that his answers in the application blank shall have the effect of warranties, and are made a part of the contract. The marine-insurance policy is also literally filled with provisions and indorsements which are declared to be warranties. Now why this emphasis? If a statement given by the insured is to be construed as a mere "representation" it need only be substantially correct, and before there can be a forfeiture the company must not only show that the statement was false, but that the falsehood was of material consequence, that is to say, was a material factor in inducing the company to accept the risk or to fix the rate. If, on the contrary, all statements are declared to be warranties, as is done in the standard fire policy, it means that they must be absolutely and literally true, and that there will be a forfeiture if the company can show that the statement was false, irrespective of the materiality of the same. By declaring the application blank or any plan or survey or description of the policy a warranty, the company relieves itself of the difficult burden of proving the materiality of the same, and its burden of proof is limited to showing that the statement was not cor-

rect. As is well stated in one case:[1] "The purpose in requiring a warranty is to dispense with inquiry, and cast entirely upon the assured the obligation that the facts shall be as represented. Compliance with this warranty is a condition precedent to any recovery upon the contract. It is, therefore, that the materiality of the thing warranted to the risk is of no consequence."

Owing to the great strictness with which warranties are interpreted, and the fact that certain companies have taken undue advantage of the use of warranties in their policies, many courts are loathe to construe statements as warranties unless expressly declared to be such in the policy. Wherever statements are not declared to be warranties, the courts give the benefit of the doubt to the insured, and will consider a statement a representation rather than a warranty. Because of the hardship and injustice which the technical enforcement of the warranty might cause, some ten states have also seen fit to enact statutes which declare warranties illegal in insurance policies. These statutes usually provide that: "Whenever the application for a policy of insurance contains a warranty clause of the truth of the answers therein contained, any misrepresentation or untrue statement in such application made in good faith by the applicant, shall not effect a forfeiture or be a ground of defense in any suit brought upon any policy issued upon the faith of such application, unless such misrepresentation or untrue statement relate to some matter material to the risk."[2] In other words, these statutes declare all statements made by the insured as representations, and must be proved material before their incorrectness will lead to a forfeiture of the policy.

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[1] Fire Insurance Co. *vs.* Arthur, 30 Pa. St., 315.

[2] The law of Pennsylvania, 1885, p. 134. Such laws also exist in Massachusetts, Kentucky, Maine, Virginia, Ohio, New Hampshire, Missouri, Georgia, and several other states.

# CHAPTER VIII

## THE RISK ASSUMED UNDER THE STANDARD POLICY

SEVERAL sections of the standard fire policy prescribe the general nature of the risk which a fire-insurance company assumes. In the very first section of the policy it is stipulated that

> "The ................ Insurance Company, in consideration of the stipulations herein named and of $...... premium, does insure .................... for the term of ........... against all direct loss or damage by fire, except as hereinafter provided, to an amount not exceeding $........., to the following described property while located and contained as described herein, and not elsewhere, to wit:"
>
> (Here follows a blank space for the written description of the property.)

In other words, the "consideration" for which an insurance company promises to give indemnity includes not merely the money premium, but also the insured's promise to comply with all the stipulations of the policy; and in view of this consideration the company agrees to insure any interest which is legally insurable against all *direct loss or damage by fire*. The policy expressly provides that the property is only insured while located and contained as described in the policy, and not elsewhere, although, as we have seen in the chapter on the "Description of the Property," this part of the policy must be interpreted with reference to the nature of the business or property which is to be insured. Lines 60 to 66 of the policy also carefully define the liability of the company in case the property is removed, in the following

words: "If property covered by this policy is so endangered by fire as to require removal to a place of safety, and is so removed, that part of this policy in excess of its proportion of any loss and of the value of property remaining in the original location shall, for the ensuing five days only, cover the property so removed in the new location; if removed to more than one location, such excess of this policy shall cover therein for such five days in the proportion that the value in any one such new location bears to the value in all such new locations; but this company shall not, in any case of removal, whether to one or more locations, be liable beyond the proportion that the amount hereby insured shall bear to the total insurance on the whole property at the time of fire, whether the same cover in new location or not."

*The Doctrine of Proximate Cause.*—An explanation of the meaning of the restrictive word "direct" in the foregoing provision involves a discussion of the doctrine of proximate cause. It frequently occurs that the property damaged or destroyed is situated far distant from the place where the fire originated, but is reached by the fire spreading from one property to another. In such cases disputes will frequently arise as to who shall be liable for the loss, especially where the factor of negligence is involved. A case in point is that of Atkinson *vs.* Goodrich Transportation Co. (60 Wisc., 141). Here the transportation company was charged with having negligently set fire to property situated a long distance from the origin of the fire, the flames having spread from building to building, until finally carried by the wind for more than a quarter of a mile to the insured premises. The court, in its opinion, gave the following rule: "The true rule is that what is the proximate cause of the injury is ordinarily a question for the jury. It is not a question of science or legal knowledge. It is to be determined as a fact, in view of all the circumstances of fact attending it. The primary cause may be the proximate cause of the disaster, though it

may operate through successive instruments, as an article at the end of a chain may be moved by the force applied at the other end, that force being the proximate cause of the movement. . . . . . . . . . . . . . The question always is, was there an unbroken connection between the wrongful act and the injury, a continuous operation? Did the effects constitute a continuous succession of events so linked as to make a natural whole, or was there some new and independent cause intervening between the wrong and the injury? It must appear that the injury was the natural and probable consequence of the negligence or wrongful act, and that it ought to have been foreseen in the light of the attending circumstances." Again, as summarized by Ostrander, "the proximate cause is not the one which is nearest in time to the result, unless such cause be independent. That must be regarded as proximate which is primary, efficient, the one which is the cause of causes. That which is only incidental and contributing is in no sense responsible for the disaster." [1] If, in such cases, the insurance company pays the claim, it becomes subrogated to the rights of the original insured, to reimburse himself through the collection of damages from the party whose negligence caused the loss. The company, however, must prove that the proximate or real cause of the loss was the negligence of the party from whom they wish to collect damages.

Numerous cases arise, however, where the doctrine of proximate cause is not connected with the subject of subrogation, but must be used to determine the liability of the insurance company itself. This is well illustrated in the case of The Lynn Gas and Electric Co. *vs.* The Meriden Fire Insurance Company (158 Mass., 570). Here the plaintiff was insured for a large amount under the Massachusetts standard fire-insurance policy, against direct loss or damage

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[1] D. Ostrander, "Law of Fire Insurance," p. 365.

by fire, and the policies of the several companies covered all the machinery and other property of the plant. It so happened that all the wires transmitting power from the building to other parts of the city emanated from a single wire tower, near which stood a waste-paper basket. In some way this basket caught fire, which fire was immediately extinguished, but not until the flames had come in contact with the mass of wires, thus producing a short circuit, which in turn affected certain pulleys and belts, until all the machinery in the building was severely strained or wrecked. The fire had done little or no damage directly, although the indirect damage reached large proportions. The companies, in a test case, denied liability, but the court held that the policies insured everything in the building. "The defendants when they made their contract understood that the building contained a large quantity of electrical machinery, and that electricity would be transmitted from the dynamos, and would be a powerful force in and about the building. They must be presumed to have contemplated such effects as fire might naturally produce in connection with machinery used in generating and transmitting strong currents of electricity."

*The Meaning of "Loss or Damage by Fire."*—Loss or damage by fire has reference only to losses which are the result of the actual ignition of the insured premises or of property near by. It is not necessary, however, that fire should actually have come in contact with any part of the insured property. Thus where the insured property is damaged by water used in extinguishing a fire in an adjacent building, or where, because of fire in a neighboring building, the damage is caused by the falling of a wall, insurance companies have again and again been held liable, even though no part of the insured property was ever reached by the fire. On the other hand, fire does not include "heat of a degree too low to cause ignition," and insurance companies

are not liable for loss or damage occasioned by overheating, as long as the fire which caused the excessive heat has not left its proper receptacle. "Loss or damage by fire" also includes damage caused by water used in preventing the destruction of the building and its contents; and, unless stipulated to the contrary in the policy, comprises loss by theft or damage by breakage resulting from the process of removing goods in order to save them from destruction.

*Excluded Risks.*—Unless the policy contains provisions to the contrary, fire-insurance companies are held liable for loss or damage by fire occasioned by any cause not expressly excepted in the policy. In view of this general rule, and for the purpose of protecting the company against certain undesirable risks, the standard fire policy contains the following provisions (lines 31 to 37, inclusive):

"This company shall not be liable for loss caused directly or indirectly by invasion, insurrection, riot, civil war or commotion, or military or usurped power, or by order of any civil authority; or by theft; or by neglect of the insured to use all reasonable means to save and preserve the property at and after a fire or when the property is endangered by fire in neighboring premises; or (unless fire ensues, and, in that event, for the damage by fire only) by explosion of any kind, or lightning; but liability for direct damage by lightning may be assumed by specific agreement hereon.

"If a building or any part thereof fall, except as the result of fire, all insurance by this policy on such building or its contents shall immediately cease."

A few words of explanation are necessary to show why the standard policy expressly excludes some of the foregoing risks. The reasons, briefly stated, are as follows:

1. Loss resulting from invasion, riot, order of any civil authority, etc., are not covered by the standard policy, partly because they are usually extraordinary losses occurring under conditions which make the extinguishment of the fire diffi-

cult, and partly because in most cases they may be recovered from the municipality or state.

2. Loss through theft in the process of removing goods is expressly eliminated, because it is especially hazardous from the standpoint of the moral hazard.

3. Loss by explosion must be distinguished from that caused by the subsequent fire, and the courts have repeatedly held that a fire and an explosion risk are inherently different. Therefore the standard fire policy provides that the company shall not be liable for loss by explosion of any kind, unless fire ensues, and in that event for the damage by fire only. This rule at times presents difficult cases for adjustment, because where a fire immediately follows an explosion it is frequently impossible to determine the amount of loss occasioned by the explosion, as separate from the loss caused by fire.

4. Loss through lightning is not covered by the policy unless the risk has been specifically assumed by an agreement indorsed on the policy, except where fire results from the lightning, and then, as in the case of explosion, the company's liability is limited to the damage occasioned by the fire. The agreement indorsed on the policy, which is called the lightning clause, usually reads as follows:

> "This policy shall cover any direct loss or damage caused by lightning (meaning thereby the commonly accepted use of the term lightning, and in no case to include loss or damage by cyclone, tornado, or windstorm) not exceeding the sum insured nor the interest of the insured in the property, and subject in all other respects to the terms and conditions of this policy."

5. Loss in case the building has fallen "in whole or in part" is not covered by the policy, on the theory that when the insured building has fallen in part or in whole, it is no longer the original building which burns, but simply the débris.

*Excluded Articles.*—Line 38 of the standard policy provides against the insuring of a list of enumerated articles, which, in most cases, are simply evidences of ownership, and therefore not inherently valuable. The policy reads: "This company shall not be liable for loss to accounts, bills, currency, deeds, evidences of debt, money, notes, or securities." These articles are not insured, partly because they afford opportunity for fraud, being subject to easy concealment; and partly because the determination of the value of these articles is difficult, the company being obliged in most cases to depend upon the statements of the insured.

Another group of articles mentioned in line 39 and following are of such a nature that the companies insure them only if liability is specifically assumed by indorsement on the policy. With reference to these articles the policy reads: "This company shall not be liable . . . unless liability is specifically assumed hereon, for loss to awnings, bullion, casts, curiosities, drawings, dies, implements, jewels, manuscripts, medals, models, patterns, pictures, scientific apparatus, signs, store or office furniture or fixtures, sculpture, tools, or property held on storage or for repairs." These articles, unlike the first group, possess value, but it is apparent that their value is not easily determined, and may be the subject of much dispute. In many instances the value may be largely a sentimental one, concerning which opinions greatly differ. Companies, therefore, before assuming liability for the loss of the same, desire to prescribe special conditions. The policy further provides that the company shall not be liable (lines 41 to 44, inclusive)

"Beyond the actual value destroyed by fire, for loss occasioned by ordinance or law regulating construction or repair of buildings, or by interruption of business, manufacturing processes or otherwise; nor for any greater proportion of the value of plate glass, frescoes, and decorations, than that which this policy shall bear to the whole insurance on the building described."

*The Company's Liability for Loss Limited to the Actual Cash Value of the Property.*—A very important provision of the standard policy is that which limits the company's liability to the actual cash value of the property at the time of the loss. The clause reads (lines 1 to 4 inclusive):

"This company shall not be liable beyond the actual cash value of the property at the time any loss or damage occurs, and the loss or damage shall be ascertained or estimated according to such actual cash value, with proper reduction for depreciation, however caused, and shall in no event exceed what it would cost the insured to repair or replace the same with material of like kind and quality; said ascertainment or estimate shall be made by the insured and this company, or, if they differ, then by appraisers, as hereinafter provided; and, the amount of loss or damage having been thus determined, the sum for which this company is liable pursuant to this policy shall be payable sixty days after due notice, ascertainment, estimate, and satisfactory proof of the loss have been received by this company in accordance with the terms of this policy."

This policy provision conforms with the true object of the fire-insurance contract, namely, to furnish indemnity for the destruction of actual property values. In other words, even though the face value of the policy is for a larger amount, the insurance company should never be held liable for more than the actual cash value of the property at the time of the fire. As explained in the chapter on "The Policy Contract," many causes operate to decrease the value of property during the interval between the time of the issuance of the policy and its maturity. Again, it should be borne in mind that even though values did not fluctuate, it is impossible for companies to make absolutely accurate inspections of the property at the time the risk is assumed. Experience shows that only about one in every ten claims represents a total loss. Out of every 100,000 properties insured only about 3,333 suffer a loss, and only about 333 suffer a total loss. Where partial losses occur, an adjustment

must be made in any case. Is it not much more desirable, therefore, from the standpoint of expense, to defer a thorough investigation, as to actual value, to the 333 cases of total loss, when the losses occur, than to make the same originally in the case of the 100,000 properties?

Despite the fundamental principle of indemnity in fire insurance, and the much greater economy in deferring careful examinations to the time of the loss, it is a most regrettable fact that nearly one half of the states of the Union have seen fit to pass laws which, in the case of realty, make the company liable for the face value of the policy in case of a total loss. Thus the recent Minnesota law (1907, Chap. 446) is to the effect that every company insuring any building against loss, shall cause the same to be previously examined and to have its insurable value determined. The law further provides that in the absence of any increase in the risk without the consent of the insurer, in which the burden of proof shall be upon the company, and in the absence of intentional fraud upon the part of the insured, the company shall be liable upon the whole amount mentioned in the policy in case of total loss. Such so-called "valued policy laws" are opposed to the very principles underlying fire insurance, and furnish a motive for fraud, resulting in the payment of dishonest claims out of the premium contributions of the honest. They have proved exceedingly expensive to the policy-holders of the states which have enacted the same, and are sure greatly to increase the moral hazard.[1]

*The Option to Rebuild or Replace.*—Following the clause just explained, lines 4 to 6 of the standard policy read, "it shall be optional, however, with this company to take all or any part of the articles at such ascertained or appraised value, and also to repair, rebuild, or replace the property lost or damaged with other of like kind and quality within a

[1] See Mr. Dean's discussion of valued policy laws contained in pp. 103 to 111 of "The Rationale of Fire Rates," Chicago, 1901.

reasonable time, on giving notice within thirty days after the receipt of the proof herein required, of its intention so to do; but there can be no abandonment to this company of the property described."

According to this provision, insurance companies may settle a claim by paying the loss, by taking all or any part of the property damaged or undamaged, or by repairing or replacing the property lost or damaged. When the company has elected one of these alternatives, its decision becomes an absolute agreement, and fixes the rights and duties of the parties.[1] Insurance companies, however, do not desire to exercise the option of repairing or replacing the property unless they deem it absolutely necessary, as, for example, when a satisfactory adjustment of a loss cannot be made. Where the insured claims what the insurance company regards as an excessive demand, the company may determine whether it would not be cheaper to restore the goods or buildings to their original condition at the time of the fire. Certainly the insured cannot object to this. Since the cost of materials varies considerably at times, the insurance company may profitably exercise this option. In numerous states, however, disputes have arisen as to what constitutes a restoration, especially since the insurance company must replace the property with property of "like kind and quality," and the courts have been severe in their rulings against the companies. Partly for this reason and partly because the insurance companies are not in the business of buying materials or constructing buildings, they prefer, whenever possible, not to exercise this option. Mention should also be made of the fact that in fire insurance, unlike marine insurance, the insured cannot abandon the property to the company and demand payment for the same.[2]

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[1] Fire Assoc. *vs.* Rosenthal, 108 Penna., 74.

[2] For an explanation of abandonment in marine insurance see the chapter on "Marine Losses."

# CHAPTER IX

## THE TERM OF THE CONTRACT—RENEWAL AND CANCELLATION

### THE TERM OF THE CONTRACT

ONE of the necessary elements in any complete contract is the agreement as to the duration of the term. In fire insurance most contracts are written for one year or less, but the term is often made to extend over two, three, and five years, and even longer. The New York Standard policy seeks definitely to state the limits of time within which the policy shall be in force by providing that the insurance shall extend "for the term of.............. from the........day of............, 191.., at noon, to the............day of ............, 191.., at noon." Some have argued that a later hour than twelve o'clock would be more convenient, since then the termination of the policy could be made to coincide with the close of a business day. By invariable custom, however, all fire-insurance policies are made to begin and end at noon.

As regards the beginning of the term, it is well settled in law that the policy takes effect on the day when it is applied for and dated. Any act on the part of the company which signifies that it accepts the risk operates to complete the contract, and the actual delivery of the policy to the applicant is relatively unimportant. An excellent illustration of this principle is afforded in the case of the Hartford Steam Boiler Insurance Company *vs.* Lasher Stocking Company, 66 Vt., 439. Here the defendant made application to

the company on May 7th for insurance and the negotiations were conducted by mail. On May 13th the company mailed the policy, but enclosed an "exhibit," which recommended that certain changes be made on the premises. The policy was received by the defendant on May 15th, but regarding the suggestions of the company as mandatory, which they were not, he returned the policy on June 1st. On June 5th, the company returned the policy to the defendant and insisted on the payment of the premium, amounting by this time to $100. The court was now called upon to fix the time when the policy began, and decided to the effect that "the law is now well settled that if an offer of a contract is made and accepted by letters, sent through the post, the contract is complete the moment the offer is posted, and this upon the ground that the post-office is regarded as an agent of the one making the proposition."

When policies cannot be delivered at once, it is common for the representative of the company to make the insurance binding in favor of the insured by issuing a so-called "binder." (See Fig. 4.) While not necessary legally to make insurance binding in the absence of the policy itself, the "binder" has the advantage of affording written evidence of the contractual relation between the parties. According to its terms, however, it is mutually agreed that it shall at once terminate and become void upon delivery of the policy in substitution, or upon the day following that upon which notice is given to the applicant or broker that the risk is declined.

In Hallock *vs.* Commercial Union Insurance Company, 26 N. J., 268, we have an instance where the insurer was held liable for a loss occurring before the contract was even accepted by the company. The application provided that if the risk proved acceptable the policy was to be antedated so as to be of even date with the application, namely, March 12th. On the next day the company mailed the policy to

**( Name and Address of Branch Office.)**

Philadelphia, Pa.,....................

Fire Insurance is made binding in favor of.............

...........................................................

from......................at noon, on...................

...........................................................

situate....................................................

in the Companies and in amounts specified below, for not exceeding........days from said date until................ ........at noon.

This insurance is made binding upon the mutual agreement that it shall at once terminate and become void upon delivery of policies in substitution, or at noon upon the day following that upon which notice is given to the applicant or broker that the risk is declined (legal holidays excepted).

Any loss occurring under this binder shall be settled as per form furnished, or in the absence of such form, as concurrent with any other insurance on same property at time of loss, and shall be adjusted in accordance with the conditions of the form of policy used by the subscribing Companies in the State of Pennsylvania.

Subject to...........Coinsurance Clause. Rate.......

| COMPANY | AMOUNT | ACCEPTED BY |
|---|---|---|
| | | |
| | | |
| | | |
| | | |
| | | |
| | | |

FIG. 4.

its agent to be delivered to the insured, but in the meantime, ten hours before the policy was actually written, the property was destroyed. Hearing of the loss, the company at once telegraphed its agent not to deliver the policy, which instruction was carried out, although the insured tendered the premium. The court held "that the contract was complete when the proposal was accepted, and that it became operative, in accordance with its own terms, at noon on the 12th day of March while the property was still in existence."[1] It was further declared, "that it was competent for the parties to make contracts that should relate back, and be operative from the time of the beginning of the negotiations, or to any other period, there is no good reason for doubt."[2]

A contract of insurance may also be issued in such a manner as to cover property distantly located, although it has already been destroyed, provided the insured had no knowledge of its status.[3] In marine insurance it is a very common practice to insure property "lost or not lost," the underwriter agreeing to pay the loss, if it later develops that the property was destroyed, prior to the date in the policy. Retroactive insurance of this kind, although rarely met with in fire insurance to-day, because of the promptness with which news can be obtained by modern methods of communication, may serve a very useful purpose in protecting property in transit, when the same is reported missing or has not been heard of for some time.

By agreement, also, the parties to the fire-insurance contract need not specify the date when the policy shall terminate, but may leave this to be determined by either party at will. When the dates are thus left in blank, the policy is

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[1] D. Ostrander, "The Law of Fire Insurance," p. 47. [2] Ibid.

[3] Illustrated by Security Fire Insurance Company *vs.* Kentucky, etc., Insurance Company, 7 Bush. (Ky.), 81 (1896).

called an "open" one. In a prominent case[1] it was decided that "the agreement that the risk should run from the first day of August, 1885, to a day to be named by the defendant is in law an agreement as to the duration of the risk, and is equivalent in law to a contract for a certain time, because under the terms of agreement, the time can be rendered certain." In fact, although the standard contract contemplates the insertion of the dates which mark the beginning and ending of the term, the weight of authority is to the effect that, should both be missing, the insurance should nevertheless be considered good "for a reasonable time." In one case the court declared,[2] "the making of the contract of insurance was not a mere idle thing. It had a substantial purpose and meaning. . . . Some meaning must be given to the insurance, and it must be regarded, we think, at least for a reasonable time."

### THE RENEWAL OF THE CONTRACT

Closely related to the term of the contract is the practice of renewal. The Standard Policy provides "that this policy may by a renewal be continued under the original stipulations, in consideration of premium for the renewed term, provided that any increase of hazard must be made known to this company at the time of renewal, or this policy shall be void." The renewing of a policy does not necessarily require the writing of a new policy. It is sometimes, though not frequently effected by the issuance of a renewal receipt, a copy of which is herewith presented. (See Fig. 5.)

The essential thing to be noted about a renewal policy is that, while in all particulars it should resemble the original

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[1] Imboden *vs.* Detroit, etc., Insurance Company, 31 Mo. App., 321 (1881).

[2] Illustrated by Schroeder *vs.* The Trade Insurance Company of Camden, 190 Illinois, 157.

contract, legally it is a new contract, which, unless expressed to the contrary, is subject to the terms of the original policy. Special privileges granted by the company under the original policy, but not part of the contract, cannot be demanded under the renewal. The case of Hartford Fire Insurance Company *vs.* Walsh, 54 Ill., 164, will serve as an illustration of what has been decided in many states. Here the owner

RENEWAL RECEIPT

Amount, \$........ Premium, \$........

THE................INSURANCE CO. OF................

(Address of company.)

Insured..............................................

In Consideration of..............................Dollars, being the premium on..............................Dollars, Policy No.........is hereby renewed and continued in force for..........to wit, from the...............day of......... 19..., at noon, until the................day of.........19.., at noon.

Dated.......................

Assistant Secretary.

FIG. 5.

insured a house under a one-year policy and renewed the insurance for two successive years. The building was destroyed by fire under the second renewal, and the company refused payment because the property had remained vacant and unoccupied for a longer time than allowed by the policy without the consent of the company. The owner admitted the fact, but argued that he had received verbal consent to a vacancy under the first renewal, and that, therefore, he had a right to expect the same treatment under the next renewal.

But the court refused to allow this claim, holding that "a renewal of a policy is in effect a new contract of assurance, and, unless otherwise expressed, on the same terms and conditions as were contained in the original policy. If, then, the property was occupied when the last renewal occurred, it, under the terms of the policy, became the duty of the assured to give the same notice that was required in the policy. . . There can be no pretense that there was a continuation of the former insurance, but it must be regarded as a new contract, under the same terms and conditions as entered into and formed the original contract of insurance."

Furthermore, the description of the property, where a policy is renewed, must apply to the property as it stands at the time of renewal; and any increase of hazard which is not disclosed will work an avoidance of the renewed policy. The risk (description of property) insured under the original policy expires when the policy expires, and each renewal must be considered as applying to a new risk. In accordance with the policy, "any increase of hazard must be made known to the company at the time of the renewal," and concealment or misrepresentation will avoid the policy. It may be here stated that authorities advise that where for any reason the original policy has been altered as to amount, location, etc., the renewal should be by a new policy and not by a "renewal receipt;" also that under no conditions should a "renewal receipt" be granted which materially changes the original contract.

With the exception of the description of the property, a renewal policy may be presumed by the holder to be in all respects like the original policy. Suppose, for example, that the original policy contained no coinsurance clause, but that the renewal policy did, and the policy-holder, relying on the good faith of the company, failed to read the renewal policy. Supposing a loss occurs, on what basis shall it be settled—with or without coinsurance? Justice would seem to dictate

that in such a case the insured should be allowed to maintain an action for a reformation of the contract. In a case[1] involving the precise facts we assumed, the court permitted the reformation of the contract and declared "the plaintiffs could not be regarded as guilty of laches in not examining the policy and applying earlier for its correction."

### CANCELLATION OF THE POLICY

*The Right of Cancellation and Reasons For.*—Unless reserved, the right of cancellation does not exist, except by mutual consent. Under the provisions of the Standard Policy, however, both parties to the contract may cancel, lines 51 to 55 of the policy providing that "this policy shall be cancelled at any time at the request of the insured; or by the company by giving five days' notice of such cancellation. If this policy shall be cancelled as herein before provided, or become void or cease, the premium having been actually paid, the unearned portion shall be returned on surrender of this policy or last renewal, this company retaining the customary short rate; except that when this policy is cancelled by this company by giving notice, it shall retain only the pro-rata premium." In several states, like Massachusetts, Minnesota, and New Hampshire, the company is required to give ten days' notice of cancellation, and in Wisconsin, although five days' notice on the part of the company is sufficient under ordinary circumstances, provision is made for sixty days' notice during times in which the hazard shall be increased solely by the act of God. In any case, the right of cancellation reserved by the company cannot be exercised under circumstances which would operate as a fraud on the insured, where, for example, the company would serve notice of cancellation at a time when the property is threatened by an approaching conflagration.

[1] Palmer *vs.* Hartford Fire Insurance Company, 54 Conn., 488.

Many reasons exist why the company should reserve the right to cancel the policy after giving due and timely notice. The company, subsequent to the issuance of the policy, may discover an undesirable moral hazard, or may become aware of a great increase in the physical hazard not considered in the original policy, such as changes in construction or processes of manufacture, or where a property is left vacant or in an unprotected condition. The company may desire to cancel a policy because it has been burned, lost, or mislaid, or because of non-payment of the premium by the policyholder. After a suspicious partial loss, the company may wish to relieve itself from further liability under the policy before a final settlement of the loss can be made; and in many cases where the adjustment of a loss, which does not involve all the property covered by the policy, is delayed, companies consider it important that, pending the settlement, they should promptly relieve themselves from further liability on the remaining property described in the policy. Or the company may decide to retire from business and desire to cancel all its policies. But whatever the reason for the cancellation of the policy, it is a well-established principle that neither the insured nor the company need offer any explanation for their decision to cancel.

*Tender of the Unearned Premium.*—To legally effect a cancellation of the policy on the part of the company, there must be an actual tender without conditions of the unearned premium for the unexpired term.[1] It is true that the cancellation clause of the standard policy was purposely so worded as to make cancellation possible without tendering the unearned premium. But the courts have variously construed this clause, holding, in most instances, that a full tender of the premium is still necessary under the standard

[1] Lisdell *vs.* New Hampshire Fire Insurance Company, 155 N. Y., 163.

policy. To avoid litigation such tender is invariably made to the insured. The cancellation notice[1] usually takes some such form as shown in Fig. 6.

*Short Rate Tables.*—As already observed the standard policy provides that, in case the company cancels the policy the unearned portion of the premium shall be returned in full. In case, however, the insured cancels the policy, the company may retain the customary "short rate." To do otherwise would enable a property owner to evade the proper charges for short risks, since, if he could receive back all premiums on the pro-rata basis, he could take a policy for a year and cancel it when no longer wanted.

As examples of the short rates which fire-insurance companies are in the habit of retaining when policies are cancelled by the insured, the following tables are given, the first being that adopted by the New York Fire Insurance Ex-

[1] In view of Supreme Court decisions, the following note is frequently attached to the cancellation notice for the guidance of the company's agents:

CANCELLATION NOTICE.

NOTE. Serve this form of notice personally, if practicable, or by registered letter, keeping memorandum on this stub, so that positive proof of service on the insured can be made. The date of terminating policy should be at least five days after service or receipt by the insured of notice. **In cases when quick and positive cancellation is desired, as when ordered by Company, etc., and when premium has been paid, make a tender of the unearned premium with service of notice and erase last three lines of notice and add "The pro rata unearned return premium is herewith tendered."** The courts hold that such tender is required for a legal cancellation.

If loss is payable to a third party, mortgagee, or otherwise, notice should be served on such party. If risk came through broker, or other agents, give notice also to them.

**SECURE THE POLICY AT THE END OF THE FIVE DAYS.**

Policy No.............Insured......................................

Notice Dated...............191    Served...............191

Served by..................................................

change for one-year policies, and the second a table adopted by the "Western Union," designed for policies running longer than one year. Except in the case of policies on contents of listed storage stores and grain elevators, which can be cancelled for less than one month at short rates for the fractional

NOTICE OF CANCELLATION

INSURANCE COMPANY

Agency at........................

....................191..

To....................................

.......................................

On the........day of................191.., the..........

....................of................, conditionally issued to you its Policy No............of this Agency of said Company, for $..........on your..............................

..................................................

..................................................

This is to notify you that in accordance with the conditions of said policy (see in particular lines 51 to 55 of policy), said Company elects to cancel and terminate its liability under same at noon of the................day of............ 191.., and by virtue of said conditions and this notice thereunder, such liability will cease and terminate at that date.

The pro rata unearned premium, if the premium has actually been paid, is held subject to your order on surrender of said policy to the undersigned Agent of said Company.

Respectfully yours,

............................

By...........................Agent.

FIG. 6.

part of a month, all policies written for a month or more are subject to the rule "that fractional parts of a month shall be charged the full month's premium; no return to be made on a policy written for a period of less than one month."

## SHORT RATE TABLE ADOPTED BY THE NEW YORK FIRE EXCHANGE

| | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Annual rate......... | 25 | 30 | 35 | 40 | 45 | 50 | 55 | 60 | 65 | 70 | 75 | 80 | 85 | 90 | 95 | 100 | 110 |
| 1 day............... | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| 2 days.............. | 1 | 1 | 1 | 2 | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 3 | 3 | 4 | 4 | 4 | 4 |
| 3 days.............. | 1 | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 3 | 4 | 4 | 4 | 4 | 5 | 5 | 5 | 6 |
| 4 days.............. | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 4 | 4 | 4 | 5 | 5 | 5 | 5 | 6 | 6 | 7 |
| 5 days.............. | 2 | 2 | 2 | 3 | 3 | 3 | 4 | 4 | 4 | 5 | 5 | 5 | 6 | 6 | 6 | 7 | 7 |
| 10 days............. | 3 | 3 | 4 | 4 | 5 | 5 | 6 | 6 | 7 | 7 | 8 | 8 | 9 | 9 | 10 | 10 | 11 |
| 15 days............. | 3 | 4 | 5 | 5 | 6 | 7 | 7 | 8 | 9 | 9 | 10 | 11 | 11 | 12 | 13 | 13 | 15 |
| 20 days............. | 4 | 5 | 6 | 7 | 8 | 8 | 8 | 10 | 11 | 12 | 13 | 13 | 14 | 15 | 16 | 17 | 18 |
| 1 month............ | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 | 18 | 19 | 20 | 22 |
| 2 months........... | 8 | 9 | 11 | 12 | 14 | 15 | 17 | 18 | 20 | 21 | 23 | 24 | 26 | 27 | 29 | 30 | 33 |
| 3 months........... | 10 | 12 | 14 | 16 | 18 | 20 | 22 | 24 | 26 | 28 | 30 | 32 | 34 | 36 | 38 | 40 | 44 |
| 4 months........... | 13 | 15 | 18 | 20 | 23 | 25 | 28 | 30 | 33 | 35 | 38 | 40 | 43 | 45 | 48 | 50 | 55 |
| 5 months........... | 15 | 18 | 21 | 24 | 27 | 30 | 33 | 36 | 39 | 42 | 45 | 48 | 51 | 54 | 57 | 60 | 66 |
| 6 months........... | 18 | 21 | 25 | 28 | 32 | 35 | 39 | 42 | 46 | 49 | 53 | 56 | 60 | 63 | 67 | 70 | 77 |
| 7 months........... | 19 | 23 | 26 | 30 | 34 | 38 | 41 | 45 | 49 | 53 | 56 | 60 | 64 | 68 | 71 | 75 | 83 |
| 8 months........... | 20 | 24 | 28 | 32 | 36 | 40 | 44 | 48 | 52 | 56 | 60 | 64 | 68 | 72 | 76 | 80 | 88 |
| 9 months........... | 22 | 26 | 30 | 34 | 38 | 43 | 47 | 51 | 55 | 60 | 64 | 68 | 72 | 77 | 81 | 85 | 94 |
| 10 months.......... | 23 | 27 | 32 | 36 | 41 | 45 | 50 | 54 | 59 | 63 | 68 | 72 | 77 | 81 | 86 | 90 | 99 |
| 11 months.......... | 24 | 29 | 33 | 38 | 43 | 45 | 52 | 57 | 62 | 67 | 71 | 76 | 81 | 86 | 90 | 95 | 105 |

| | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Annual rate.... | 125 | 150 | 175 | 200 | 225 | 250 | 275 | 300 | 325 | 350 | 375 | 400 | 450 | 500 |
| 1 day.......... | 3 | 3 | 4 | 4 | 5 | 5 | 6 | 6 | 7 | 7 | 8 | 8 | 9 | 10 |
| 2 days......... | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 18 | 20 |
| 3 days......... | 6 | 8 | 9 | 10 | 11 | 11 | 13 | 15 | 16 | 18 | 19 | 20 | 23 | 25 |
| 4 days......... | 8 | 9 | 11 | 12 | 14 | 15 | 17 | 18 | 20 | 21 | 23 | 24 | 27 | 30 |
| 5 days......... | 8 | 10 | 12 | 13 | 15 | 17 | 18 | 20 | 22 | 23 | 25 | 27 | 30 | 33 |
| 10 days........ | 13 | 15 | 18 | 20 | 23 | 25 | 28 | 30 | 33 | 35 | 38 | 40 | 45 | 50 |
| 15 days........ | 17 | 20 | 23 | 27 | 30 | 33 | 37 | 40 | 43 | 47 | 50 | 53 | 60 | 67 |
| 20 days........ | 21 | 25 | 29 | 33 | 38 | 42 | 46 | 50 | 54 | 58 | 63 | 67 | 75 | 83 |
| 1 month....... | 25 | 30 | 35 | 40 | 45 | 50 | 55 | 60 | 65 | 70 | 75 | 80 | 90 | 100 |
| 2 months...... | 38 | 45 | 53 | 60 | 68 | 75 | 83 | 90 | 98 | 105 | 113 | 120 | 135 | 150 |
| 3 months...... | 50 | 60 | 70 | 80 | 90 | 100 | 110 | 120 | 130 | 140 | 150 | 160 | 180 | 200 |
| 4 months...... | 63 | 75 | 88 | 100 | 113 | 125 | 138 | 150 | 163 | 175 | 188 | 200 | 225 | 250 |
| 5 months...... | 75 | 90 | 105 | 122 | 135 | 150 | 165 | 180 | 195 | 210 | 225 | 240 | 270 | 300 |
| 6 months...... | 88 | 105 | 123 | 140 | 158 | 175 | 193 | 210 | 228 | 245 | 263 | 280 | 315 | 350 |
| 7 months...... | 94 | 113 | 131 | 150 | 169 | 188 | 206 | 225 | 244 | 263 | 281 | 300 | 338 | 375 |
| 8 months...... | 100 | 120 | 140 | 160 | 180 | 200 | 220 | 240 | 260 | 280 | 300 | 320 | 360 | 400 |
| 9 months...... | 106 | 128 | 149 | 170 | 191 | 213 | 234 | 255 | 276 | 298 | 319 | 340 | 383 | 425 |
| 10 months..... | 113 | 135 | 158 | 180 | 203 | 225 | 248 | 270 | 293 | 315 | 338 | 360 | 405 | 450 |
| 11 months..... | 119 | 143 | 166 | 190 | 214 | 238 | 261 | 285 | 309 | 333 | 356 | 380 | 428 | 475 |

## SHORT RATE TABLE ADOPTED BY THE "WESTERN UNION" FOR TERM RISKS

### THREE YEARS

| | |
|---|---|
| For 3 months or less | 20% of Term Premium |
| Over 3 and not exceeding 6 months | 30% of Term Premium |
| Over 6 and not exceeding 9 months | 40% of Term Premium |
| Over 9 and not exceeding 12 months | 50% of Term Premium |
| Over 12 and not exceeding 15 months | 60% of Term Premium |
| Over 15 and not exceeding 18 months | 70% of Term Premium |
| Over 18 and not exceeding 21 months | 75% of Term Premium |
| Over 21 and not exceeding 24 months | 80% of Term Premium |
| Over 24 and not exceeding 27 months | 85% of Term Premium |
| Over 27 and not exceeding 30 months | 90% of Term Premium |
| Over 30 and not exceeding 33 months | 95% of Term Premium |
| Over 33 months | 100% of Term Premium |

### FOUR YEARS

| | |
|---|---|
| For 4 months or less | 20% of Term Premium |
| Over 4 and not exceeding 8 months | 30% of Term Premium |
| Over 8 and not exceeding 12 months | 40% of Term Premium |
| Over 12 and not exceeding 16 months | 50% of Term Premium |
| Over 16 and not exceeding 20 months | 60% of Term Premium |
| Over 20 and not exceeding 24 months | 70% of Term Premium |
| Over 24 and not exceeding 28 months | 75% of Term Premium |
| Over 28 and not exceeding 32 months | 80% of Term Premium |
| Over 32 and not exceeding 36 months | 85% of Term Premium |
| Over 36 and not exceeding 40 months | 90% of Term Premium |
| Over 40 and not exceeding 44 months | 95% of Term Premium |
| Over 44 months | 100% of Term Premium |

### FIVE YEARS

| | |
|---|---|
| For 5 months or less | 20% of Term Premium |
| Over 5 and not exceeding 10 months | 30% of Term Premium |
| Over 10 and not exceeding 15 months | 40% of Term Premium |
| Over 15 and not exceeding 20 months | 50% of Term Premium |
| Over 20 and not exceeding 25 months | 60% of Term Premium |
| Over 25 and not exceeding 30 months | 70% of Term Premium |
| Over 30 and not exceeding 35 months | 75% of Term Premium |
| Over 35 and not exceeding 40 months | 80% of Term Premium |
| Over 40 and not exceeding 45 months | 85% of Term Premium |
| Over 45 and not exceeding 50 months | 90% of Term Premium |
| Over 50 and not exceeding 55 months | 95% of Term Premium |
| Over 55 months | 100% of Term Premium |

# CHAPTER X

## OTHER INSURANCE

WITH reference to "other insurance" (the terms "double insurance," "overinsurance," and "multiple insurance" are also often used to indicate the procuring of more than one policy upon the same interest in a property) the standard fire policy contains the following provision (lines 11 to 13): "This entire policy, unless otherwise provided by agreement indorsed hereon or added hereto, shall be void if the insured now has, or shall hereafter, make or procure any other contract of insurance, whether valid or not, on property insured in whole or in part by this policy." This clause, or one very similar to it in wording, is found in every modern fire-insurance policy. Its object is not to prevent different persons from insuring their respective interests in a given property, but simply to make impossible the taking out of more than one policy on a single interest, except with the knowledge and sanction of the insurer. Writers on this phase of the fire-insurance business all emphasize the importance of using as much caution in restricting the total amount of insurance written on a property under a number of policies as when all the insurance is carried in one policy. The clause has been declared reasonable and valid. It is important to the company, in that it makes overinsurance difficult, and greatly lessens the moral hazard. Because of its general use, incendiarism is lessened, and the public is benefited by a decrease in the loss resulting from carelessness on the part of property owners who know that their property is fully or more than fully insured.

*The History of this Clause.*—The development of the "other insurance" clause in fire insurance is an interesting one, and may be divided into three stages. Originally no provision was made in the policy against the taking of other insurance, and the policy-holder could procure as much insurance as he desired. Then in case of loss he could exercise the option of collecting his insurance from any one or more of these insurers. The insurer thus selected would in turn seek reimbursement from the other underwriters on the risk. The principle, however, was strictly adhered to that fire insurance is indemnity, and that the insurers were never liable for more than the actual loss. Later, when "other insurance" clauses first came into use, they were worded so as to exempt the insurer from liability in case no notice was given of prior insurance. Subsequent insurance, however, would not invalidate the policy, and in determining the priority or subsequence of different policies, fractions of a day were considered.

When insurance became more general, and the necessity for carefully restricting other insurance was more apparent, the "other insurance" clause was so worded as to prohibit the procuring of additional insurance, except when permitted, whether it was "prior, concurrent, or subsequent." This clause apparently would seem to cover all contingencies, yet it was not long before three distinct lines of court decisions developed in the different states. In one group of states, like Massachusetts and Pennsylvania, the supreme courts held that the prior insurance was valid on the ground that the subsequent insurance policy never really had an existence, because of the provision against other insurance which it contained. Since the subsequent policy could not come into existence, it therefore followed that the prior policy was not invalidated. Another group of courts took the view that the subsequent policy, whether it could be enforced or not, did invalidate the prior policy. And, lastly, a mid-

dle view was taken in the state of Iowa, according to which the validity of the prior policy depended upon whether or not the subsequent policy was recognized as valid by the company which wrote it. If the subsequent policy was declared by the insurer to be valid, the prior policy would be invalid because its provision against other insurance was violated by the taking of the subsequent insurance. On the contrary, if the insurer did not recognize the subsequent policy, the prior policy was declared to be valid, because no other policy existed to violate its stipulation against other insurance.

Whatever might be thought of the wisdom or correctness of these conflicting views, it is certain that the companies could not afford to leave the meaning of this important provision of the policy in doubt. To remove all ambiguity the "other insurance" clause of the standard policy was especially worded so as to overcome the conflicting decisions of the courts. It will be noted that the clause provides that the entire policy shall be void if the insured "*now has or shall hereafter make or procure*" any other contract of insurance "*whether valid or not.*" As it now stands, the clause has, with a very few exceptions, been given full force by the courts. If the insured cannot conveniently comply with the clause by giving the proper notice, he may make arrangements with the company whereby it will indorse on his policy a clause to the effect that "$.......other insurance, concurrent herewith, permitted."

*Other Insurance Covering a Part of the Property.*—It is the general rule that where the policy is declared to be entire, the taking out of other insurance upon any part of the property insured will work a forfeiture of the entire policy. As an illustration, let us assume that the owner of a building and its contents has both items insured under one policy, and later takes out another policy on the contents, without obtaining the permission of the companies involved. By

this act both policies are forfeited, because in law the procuring of insurance on one of the items, the contents in this case, will also render void the insurance on the building. In a previous chapter it was stated that where the premium is one the policy is also one, i.e., must be considered in its entirety, and the violation of the other insurance clause as regards one of the items will bring about a forfeiture of the policy on all the items. To this general rule, however, the law of Pennsylvania is an exception. A case in point is that of Clark *vs.* Western Assurance Company, 146 Pa. St., 561. According to the facts of this case "A" took out a policy of insurance in the "B" company upon electric lamps, shades, and all other electric fixtures, while contained in a certain hotel. The policy contained a provision that the company should not be liable for a greater proportion of any loss on the described property than the amount insured under the policy bore to all the insurance on the property. "A" held another policy for $5,000 in the "C" company on the household goods and fixtures of every kind while contained in the hotel. The property insured by the "B" company was destroyed by fire, and in an action against "B" on its policy the lower court held that the two policies were on the same property, and that "A" was accordingly entitled to recover only in the proportion that "B's" policy bore to the total insurance, including "C's" policy. The case, however, was reversed by the Supreme Court on the ground that the policies did not legally cover the same property.

A brief explanation should also be given here of the relation of "other insurance" to the renewal and substitution of policies. If other insurance has been permitted, and the additional policy is later renewed without the consent and knowledge of the company it is generally considered not a violation of the other insurance clause, although in a few states a contrary opinion prevails. Likewise, if the addi-

tional insurance, which has been permitted by the company, is cancelled or allowed to expire, and an equal or smaller amount is secured in another company to take its place, no violation of the other insurance clause is generally considered to have taken place.

*The Other Insurance Clause in Marine Insurance.*—At this point it may not be out of place to state that the practice of arranging for other insurance in American marine policies is totally different from that just explained. The clause common to marine policies insured by American companies reads as follows: "Provided always, and it is hereby further agreed, that if the said assured shall have made any other assurance upon the premises aforesaid, prior in day of date to this policy, then the said......... Company shall be answerable only for so much as the amount of such prior assurance may be deficient toward fully covering the premises hereby assured, and the said............ Company shall return the premium upon so much of the sum by them assured, as they shall be by such prior assurance exonerated from, and in case of any assurance upon the said premises, subsequent in day of date to this policy, the said ............Company shall nevertheless be answerable for the full extent of the sum by them subscribed hereto, without right to claim contribution from such subsequent assurers, and shall accordingly be entitled to retain the premium by them received, in the same manner as if no such subsequent assurance had been made. Other assurance upon the premises aforesaid, of date the same day as this policy, shall be deemed simultaneous herewith, and the said............ Company shall not be liable for more than a ratable contribution in proportion of the sum by them insured to the aggregate of such simultaneous assurance." This clause not only explains the manner in which the various insurers of a marine risk contribute to the payment of a loss, but clearly indicates, in view of the absence of any clause prohibiting

the taking of additional insurance without permission, that other insurance may thus be taken. It should be noted, however, that the subsequent policies have a large measure of protection, since in case of loss the prior policies must first be exhausted, before any liability attaches.

# CHAPTER XI

## CONTRIBUTION IN FIRE INSURANCE

"CONTRIBUTION," or the apportionment of loss where several fire-insurance policies have been written on the same interest, involves some of the most important and, at the same time, most perplexing problems to be met with in the adjustment of losses.[1] Lines 96 to 100 of the standard fire policy provide that "this company shall not be liable under this policy for a greater proportion of any loss on the described property, or for loss by and expense of removal from premises endangered by fire, than the amount hereby insured shall bear to the whole insurance, whether valid or not, or by solvent or insolvent insurers, covering such property, and the extent of the application of the insurance under this policy or of the contribution to be made by this company in case of loss, may be provided for by agreement or condition written hereon or attached or appended hereto."

*Apportionment of Loss where the Policies are Concurrent.*—Where the several policies covering the same interest are alike in all their terms, i.e., are "concurrent," the application of the foregoing rule is a simple matter. For the purpose of explanation, let us assume that the owner of a

[1]The best discussion of contribution, involving an explanation of the various rules for apportionment of losses, and a statement of the principal legal decisions, is contained in W. H. Daniel's "The Apportionment of Loss and Contribution of Compound Insurance." Published by Rough Notes Co., Indianapolis, Ind., 1904. An excellent discussion, from a legal standpoint, is also found in Ostrander's "The Law of Fire Insurance."

property valued at $40,000 has the same insured to the extent of 80 per cent of its value, or $32,000, in three different companies as follows: in Company "A" $8,000, in Company "B" $10,000, and in Company "C" $14,000. Now let us assume that a loss of $10,000 occurs. If all the policies agree in their wording, and cover the same interest, it follows from the apportionment clause just quoted that each insurer is liable for the payment of only a ratable proportion of the $10,000 loss. Since Company "A" carried only $8,000 of insurance on the risk, it will not be liable for a greater proportion of the $10,000 than the amount of its insurance ($8,000) bears to the whole insurance on the property ($32,000), or one fourth. In the same way Company "B" will only be liable for $\frac{10}{32}$ of the $10,000 loss, i.e., the proportion that its insurance, $10,000, bears to the total insurance of $32,000, and Company "C's" liability will be limited to $\frac{14}{32}$. Company "A," therefore, will pay $2,500 of the loss, Company "B" $3,125, and Company "C" $4,375. It will be apparent that if the insured carries insurance equal to or greater than the amount of the loss, this loss will be paid in full. In fact, the courts have decided again and again that where the insurance exceeds the loss, no rule of apportionment can be recognized which will not fully indemnify the insured.

Special mention should be made of that section of the contribution clause, which provides for pro-rata apportionment among all the policies, "whether valid or not, or by solvent or insolvent insurers." Such a clause avoids many troublesome questions, as to the validity of policies and the solvency of companies, which would frequently arise where a number of policies cover the same property and which would have to be settled before the loss could be apportioned. But by expressly declaring that invalid policies or policies issued by insolvent companies must contribute just like the others, it becomes possible to avoid the expense and

delay always connected with any inquiries into the validity of policies or the solvency of companies. This part of the apportionment clause is also of the greatest importance to the property owner who may rely upon the chance that he will only suffer a partial loss, and may, therefore, feel that he can afford, in part at least, to take cheap insurance in an unreliable company. If the policies of insolvent companies were not considered as contributing with those of the solvent companies, it would inevitably follow that property owners, who are constantly on the lookout for cheap insurance, would take part of their insurance in reliable companies charging adequate rates, with a view to covering their partial losses, and then, as a protection against unusual losses which they hardly expect, would take other insurance in unreliable companies charging inadequate rates. The contribution clause as it stands, however, gives fair warning to property owners that such a practice can prove of no benefit because, whether the loss be partial or total, all policies in companies unable to pay will be considered as contributing on a pro-rata basis with those issued by solvent insurers. If in the foregoing illustration Company "C" should have been able to pay only 50 cents on the dollar, it would, nevertheless, be considered as having contributed $\frac{14}{32}$ of the \$10,000 loss. Companies A and B, despite the insolvency, would pay only their respective portions of $\frac{1}{4}$ and $\frac{5}{16}$ of the loss, and the property owner would be the loser of one half of Company C's liability, or \$2,187.50.

*Contribution when the Policies are Non-Concurrent.*—As contrasted with the foregoing, much greater difficulties present themselves in the apportionment of a loss when two or more policies are issued on the same interest and are "non-concurrent," i.e., do not agree in their terms. As sometimes happens, a number of policies may be written on the same interest, and differ as to the description of the property, one policy insuring the building, another covering the

building and furniture within it, and still another insuring the furniture and general merchandise. Or it may happen that certain policies are "specific," and cover only one item of property, whereas other policies are "general" (sometimes called "blanket" policies or "compound" policies), and cover all the items under one sum. Again it may happen that the policies on a given interest do not agree as regards important indorsements, one policy, for example, containing a three-quarter's loss clause and another containing no such limitation.

Non-concurrent policies on the same interest are usually the result of carelessness on the part of the agent, and in case of loss always result in much dissatisfaction. Companies instruct their agents, in order to avoid the issuing of such contracts, to refuse a policy where the insured declines to make known the wording of policies already covering the property. And where the nature of the other policies is revealed and they are found to vary in their wording, it is deemed best to have their terms so changed that they will be concurrent with the new insurance. Where this is not done, hopeless confusion will arise which no system of apportionment can accurately solve. In most instances the companies have sought to adjust such cases outside of the courts through the application of some arbitrary rule; and where the courts have undertaken to prescribe a method of settlement, the attempt has usually been far from satisfactory. As a rule a study of the court decisions shows that whenever a case of apportioning a loss among non-concurrent policies was brought up for consideration, only two plans were considered by the court, namely, "the two rules of apportionment contended for by the parties to the suit." The court would then attempt to place the different policies as much as possible upon a footing of equality, and would approve that rule of apportionment which would pay the insured the full amount of the loss. As stated by Daniels, "the courts have

repeatedly decided that if the insured has as much or more insurance than the amount of loss, his loss must be paid in full, and no rule of apportionment which fails to pay the loss in full will be recognized by the courts."

*The Various Rules in Use for the Apportionment of Loss among Specific and Compound Policies.*—The difficulties which present themselves in the apportionment of losses when some of the policies are "specific" and others are "compound," are well illustrated by the case submitted for solution to Mr. W. H. Daniels. According to the case the Continental Insurance Company insured $2,500 on wheat, $3,000 on corn, and $2,000 on oats, or a total insurance of $7,500. Two other companies, however, the Ætna and Home, insured $5,000 and $6,000 respectively on "grain." The value of the wheat, corn, and oats was respectively $8,000, $7,000, and $10,000; and the loss on these three items in the order given was $3,000, $4,000, and $8,000. Now what should be the method of apportioning this loss among the several policies, and how much should be paid under each?

In answering this question, Mr. Daniels makes the following introductory statement:

"You may not fully realize the importance of the proposition you have submitted to me for my consideration. It involves some of the most intricate questions we find in the adjustment of losses, and for many years such cases as you have submitted have been the source of serious anxiety in the loss departments of the various insurance companies, and have been the basis for a large number of contests before the courts. The insurance men of the past, and of to-day, who were, and are, because of their interest and work in the adjustment of loss claims, thoroughly posted, have not agreed and do not agree what each company should pay in such a case as you have submitted. Similar cases have received the attention of the courts during the past fifty years, and it is safe to say that the decisions of the courts as to how the losses in your case should be apportioned among the companies are not in harmony."

Judge Ostrander, likewise, in discussing a legal decision

in which the court came to the conclusion that the apportionment would have to be entirely arbitrary, states:

"Then, as now, no learning of the courts, no ingenuity of the counsel, can explain that which is essentially inexplicable. Cases are sometimes presented where the complications defy human understanding. When this occurs—when reason is baffled and mathematics fail—arbitrary action becomes a necessity. The knot we cannot untie must be cut."[1]

In his work on "The Apportionment of Loss and Contribution of Compound Insurance," Mr. Daniels applies the following rules of apportionment used in different locations to the foregoing case, and shows that each will result in different amounts being paid under the several policies involved.

THE READING RULE

"Compound insurance shall contribute with specific in proportion as the value of the specific property bears to the value of all the property covered by the compound policy" (Daniels, p. 7).

THE CROMIE RULE

"When the compound insurance covers property which is not covered by the specific insurance, a portion of the compound insurance equal to the amount of loss on the property not covered by the specific insurance must be set aside to pay the loss. The remainder of the compound insurance contributes with the specific to pay the loss on the property covered by the specific insurance. If the loss on the property covered only by the compound insurance is equal to or greater than the amount of the compound insurance, the compound insurance will be exhausted and there will be nothing to contribute from to help out the specific insurance" (Daniels, p. 7).

THE CHICAGO RULE

"The compound insurance contributes from its full amount with the specific, to pay the loss on the first item in the general form

[1] D. Ostrander, "The Law of Fire Insurance," p. 496.

on which there is a loss. The remainder of the compound insurance, after deducting amount of loss paid, contributes with the specific insurance on the next item in the general form on which there is a loss. This plan to be followed until the whole loss is paid or the compound insurance is exhausted" (Daniels, p. 23). This rule is widely used by Chicago adjusters.

### THE HARTFORD RULE

"The compound insurance contributes from its full amount with the specific to pay the loss on the item covered by specific insurance on which there is the largest loss. The remainder of compound insurance after deducting amount of loss paid contributes with the specific insurance on the item having the second largest loss. This plan to be followed until the whole loss is paid or the compound insurance is exhausted" (Daniels, p. 25). Also see Schmaelzle *vs.* London & Lancashire Insurance Co., 53 Atl. Reporter, 841.

### THE GRISWOLD RULE

"Compound policies become specific and cover the several subjects under their protection in the exact proportions of the respective losses thereon" (Daniels, p. 52). Also see Cromie *vs.* Kentucky & Louisville Insurance Co., 15 B. Monroe (Ky.), 432.

### THE KINNIE RULE

"The principle governing all apportionments of non-concurrent policies is that general and specific insurance must be regarded as coinsurances; and general insurance must float over and contribute to loss on all subjects under its protection, in the proportions of the respective losses thereon, until the assured is indemnified, or the policy exhausted" (Daniels, p. 53).

*Illustration of Apportioning Compound Insurance.*—To illustrate one of the principles of apportioning the general policy over the various items of property insured, the following example and its solution, as discussed by Judge Ostrander,[1] will prove instructive. Judge Ostrander regards as most equitable the principle that where general and specific insurance exists on a property, the general policy

[1] Ostrander, "The Law of Fire Insurance," pp. 493–495.

"should apply to each item for purposes of contribution in the proportion that the value of each item bears to the total value of the property." In applying this principle he uses the following example:

Let us assume that "A" owns a stock of merchandise valued at $20,000 and distributed over the following items as follows:

| | |
|---|---|
| Dry goods valued | $10,000 |
| Boots and shoes valued | 5,000 |
| Groceries and hardware valued | 5,000—$20,000 |

Let us assume that those three items of stock are insured as follows:

| | |
|---|---|
| On the general stock | $8,000 |
| Boots and shoes and dry goods | 6,000 |
| Groceries and hardware | 3,000—$17,000 |

Let us assume that a loss of $13,000 occurs as follows:

| | |
|---|---|
| On dry goods | $5,000 |
| On boots and shoes | 4,000 |
| On groceries and hardware | 4,000—$13,000 |

According to the illustration chosen by Ostrander the value of the property is $20,000. The insurance, $17,000, is taken out in three policies, one of which is general, two of which are specific, but all of which are non-concurrent, as regards the description of the property. Applying the principle that the general policy should apply in the proportion that the value of each item respectively bears to the whole value, the general policy will apply as follows to the various items:

$4,000 of general policy applies to dry goods,

$$\frac{\$10{,}000 \text{ (value of dry goods)}}{\$20{,}000 \text{ (total value)}} \times \frac{\$8{,}000, \text{ i.e. (amt. gen. policy)}}{1} = \$4{,}000$$

$2,000 of general policy applies to boots and shoes, i.e.,

$$\frac{\$5{,}000 \text{ (value of boots and shoes)}}{\$20{,}000 \text{ (total value)}} \times \frac{\$8{,}000}{1} = \$2{,}000$$

$2,000 of general policy applies to groceries and hardware, i.e.,

$$\frac{\$5{,}000}{\$20{,}000} \times \frac{\$8{,}000}{1} = \$2{,}000$$

Thus apportioned the total insurance would then be distributed as follows:

| | | |
|---|---|---|
| $8,000 on dry goods, i.e. | $4,000 by the general policy<br>$4,000 by other insurance | value $10,000 |
| $4,000 on boots and shoes, i.e. | $2,000 by general policy<br>$2,000 by other insurance | value $5,000 |
| $5,000 on groceries and hardware, i.e. | $2,000 by general policy<br>$3,000 by the other policy | value $5,000 |

A few words may be necessary to explain why $8,000 of insurance on dry goods is divided into $4,000 for the general policy and $4,000 for other insurance. As stated above, $4,000 of the general policy applies to dry goods. There happens, however, to be another policy of $6,000 on boots and shoes and dry goods available, but we saw that $2,000 of the general policy applies to boots and shoes, consequently leaving available $4,000 of the $6,000 as protection for the dry goods. Consequently, if we add this $4,000 other insurance to the $4,000 under the general policy, we obtain the $8,000 insurance on dry goods valued at $10,000. In the same way the amount of insurance on the other items is ascertained. Having ascertained the amount of insurance to be allotted to each item, it is then simply a question of applying the contribution clause of the standard fire policy, i.e., each policy is to pay the loss in the proportion that its insurance bears to the total insurance on the item.

But some difficulty may arise if the amount of loss on the dry goods, let us say, happens to be total, or $10,000. Then it is apparent that the foregoing rule of apportioning the general policy will not fully indemnify the insured, a contingency which we saw the courts always seek to avoid. Some other method of apportionment must therefore be found in order to give full indemnity. Under such a contingency, as Judge Ostrander explains, a reapportionment of the balance of the blanket insurance may be resorted to until the insured shall be paid his whole loss. In other words, if a

loss of $10,000 occurs on dry goods a deficit of $2,000 remains to be made up. The question now is, how much insurance still remains untaxed? We saw that only $4,000 of the general policy of $8,000 has been taxed, thus leaving $4,000 untaxed, and we also saw that $2,000 of the $6,000 policy on "boots and shoes and dry goods" still remains untaxed. In all, therefore, $6,000 of insurance exists which has not yet been taxed, and which is, therefore, available to cover the $2,000 deficit.

$4,000 of general policy left
$2,000 of the policy on boots and shoes and dry goods.
$6,000 of insurance untaxed to cover $2,000 loss.

Applying the contribution clause we then find that the general policy fairly pays that proportion of the $2,000 deficit which its portion untaxed, $4,000, bears to the total insurance untaxed, $6,000, or two thirds; while the other policy fairly pays the balance of the $2,000 deficit, or one third.

In passing judgment on this method, Judge Ostrander explains that "strong objections may be urged against this rule in many cases, although the principle on which it rests would seem to be unassailable." He goes on to say that, "on the other hand, much may be said in favor of the dictum that the blanket must pay," chiefly because the company issuing such policy has neglected to preserve its rights as it might have done, and as has been done by the company having the specific policy; and there are reasons why it should not be allowed to claim any benefits, because of the incidental fact that it finds a specific policy on some portion of the property where, in the absence of such other insurance, it would properly be obliged to follow, and pay the whole loss, up to the full amount for which it was written."

# CHAPTER XII

## PROVISIONS OF THE POLICY WHICH APPLY AFTER A LOSS HAS OCCURRED

THE provisions of the fire-insurance policy fall into two general classes, separated by the fact of the loss. While all provisions of the policy are to be considered as binding upon the parties to the contract, they are not, for purposes of legal interpretation, treated as equally important. In fact, nearly one fourth of the standard fire policy consists of provisions which concern matters that are required to be done by the insured after the main fact—a loss—has taken place. In the main the courts have regarded these provisions more leniently than those which concern matters required to be done before a loss has occurred. Where doubt as to the meaning exists, the provisions are usually construed favorably to the insured, and the courts are also more easily satisfied as to the existence of a waiver. The provisions which apply after a loss has taken place may be grouped under three distinct heads, viz.: (1) those defining "notice of loss" and "proof of loss"; (2) those providing for the exhibition of records and the examination of the insured; and (3) those relating to the appraisal of the loss in case of disagreement.

*Notice of Loss and Proofs of Loss.*—The provisions of the standard policy relating to the giving of notice of the loss and the furnishing of the proof is the following:

"If fire occur, the insured shall give immediate notice of any loss thereby in writing to this company, protect the property from further damage, forthwith separate the damaged and undamaged personal property, put it in the best

possible order, make a complete inventory of the same, stating the quantity and cost of each article, and the amount claimed thereon; and, within sixty days after the fire, unless such time is extended in writing by this company, shall render a statement to this company, signed and sworn to by said insured, stating the knowledge and belief of the insured as to the time and origin of the fire; the interest of the insured and of all others in the property; the cash value of each item thereof and the amount of the loss thereon; all incumbrances thereon; all other insurance, whether valid or not, covering any of said property; and a copy of all the descriptions and schedules in all policies; and changes in the title, use, occupation, location, possession, or exposures of said property since the issuing of this policy; by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of fire; and shall furnish, if required, verified plans and specifications of any building, fixtures, or machinery destroyed or damaged; and shall also, if required, furnish a certificate of the magistrate or notary public (not interested in the claim as a creditor or otherwise, nor related to the insured) living nearest the place of fire, stating that he has examined the circumstances and believes the insured has honestly sustained loss to the amount that such magistrate or notary public shall certify."

Almost without exception, it is a requirement of insurance policies that, when a loss occurs, the insured shall give "immediate" notice in writing. Some policies specify a definite time within which notice must be given, as five days or ten days, and in such cases, if the insured neglects to comply with the terms of the condition, he will be doing so at his peril. The courts have recognized the reasonableness of requiring the insured to give "immediate" notice of a loss to the insurer. Prompt notice enables the company to take effective measures toward lessening the loss by properly protecting against further injury such merchandise or other

property as may have been partly destroyed or left exposed. Immediate notice of the loss will also enable the company to learn the essential facts which surround the origin of the fire, thus preventing the removal or concealment of evidence which would tend to show fraud.

The expression "immediate notice of loss," however, has been given a reasonable construction by the courts. In many cases where immediate notice of loss could not be furnished at once because of good reasons, the courts have protected the insured. Thus, in the case of Kentzler *vs.* American Mutual Accident Association (88 Wis., 589), the court said: "A contract should not be construed so as to forfeit or render nugatory the rights of one of the parties to it, unless the language employed imperatively requires such construction. In other words, an interpretation which gives effect is preferred to one which makes void. "Immediately" cannot be given the meaning of instantly, but to make good the deeds and interests of parties, it shall be construed 'such convenient time as is reasonably requisite for doing the thing.'" A great many other cases have been rendered to the same effect, in some cases it being held that thirty days' delay is not too long because of a good excuse, whereas in other cases a delay of six or seven days was regarded as too long because no good reason for the delay could be offered.

Also as regards the furnishing of proofs of loss the courts have upheld the provisions of the policy, where they could be easily complied with; but where this could not be done, have refused to construe the same strictly. Proofs of loss are necessary to enable the company to determine the extent of the loss, and to ascertain whether the insured complied with the terms of the policy. Yet there are many circumstances which the courts have accepted as sufficient to excuse the policy-holder from submitting the proofs of loss in the form or within the time required by the policy. Nor do the courts regard proofs of loss, although sworn to, as conclu-

sive against the insured. If the insured is acting in good faith, and desires to show that the real value of the property destroyed exceeds the amount stated in the proofs, he may recover upon the higher valuation (see Lebanon Mutual Insurance Co. *vs.* Kepler, 106 Pa., 28).

*Certificate of a Notary Public as Part of the Proofs of Loss.*—That portion of the clause which provides that the insured shall furnish as part of his proofs of loss, a certificate from a magistrate or notary public that he believes the claim to be honest, has always been regarded as valid and obligatory. As is explained in many legal treatises, this provision has in slightly differing form always constituted a part of the proofs of loss. Originally the policy usually designated that such certificates were to be made by clergymen or church wardens, presumably because they possessed the intelligence, power of judgment, and moral character to qualify them to form reliable opinions. With the ascendency of civil authority, as contrasted with the ecclesiastical, the policy substituted the local magistrate or notary public. The same reasons which led to the introduction of this clause in early policies are present to an even greater extent to-day. Under the widely extended agency system the insurance company is practically unable to know its patrons personally, and consequently in case of loss is dependent upon the information as regards the origin of the fire and the good faith of the insured as furnished by the best citizens in the immediate locality in which the property was situated. As stated by Mr. Ostrander, "the purpose of this requirement has been to protect the insurer against wrong-doing by direct appeal to the candor and fair-mindedness of some reputable person who is acquainted with the claimant, but not interested in the loss, and who can with little trouble inquire into the circumstances of the fire, or if the claim be without merit then the provision will operate to defeat fraud and save the insurer from becoming the victim of the crime."

*The Exhibition of Property and Records and the Examination of the Property Owner.*—With reference to this feature the standard fire policy contains the following provision: "The insured, as often as required, shall exhibit to any person designated by this company all that remains of any property herein described, and submit to examinations under oath by any person named by this company, and subscribe the same; and, as often as required, shall produce for examination all books of account, bills, invoices, and other vouchers, or certified copies thereof, if originals be lost, at such reasonable place as may be designated by this company or its representative, and shall permit extracts and copies thereof to be made."

In this connection it only remains to be said that the provision has always been upheld by the courts, and that the examination must be made at the place of the fire, unless the parties by common agreement choose some other place. To give better effect to this clause a so-called "iron-safe clause" is frequently indorsed on the policy with a view to protecting books of account and other records against loss. The clause usually provides that "the assured under this policy hereby covenants and agrees to keep a set of books showing a complete record of business transacted, including all purchases and sales both for credit and cash, together with last inventory of said business, and further covenants and agrees to keep such books and inventory securely locked in a fireproof safe at night, and at all times when the store mentioned in the within policy is not actually open for business, or in some secure place not exposed to a fire which would destroy the house where such business is carried on, and in case of loss, the assured agrees and covenants to produce such books and inventory, and in the event of failure to produce the same, this policy shall be deemed null and void, and no suit or action at law shall be maintained thereon for any such loss."

*The Appraisal Clause of the Standard Fire Policy.*—In the settlement of losses it frequently occurs that the insurer and insured cannot agree as to the amount that should be paid. The insurance company naturally wishes to reduce its loss as much as possible and the insured, on the other hand, is apt to claim an excessive sum. As middleman between these two parties, the adjuster of losses will strive to effect a fair and mutually satisfactory settlement. Yet, owing to differences of opinion as to the value of buildings or merchandise, or to the absence of inventories, invoices, and other records, cases extremely difficult for settlement often arise. To make possible the speedy solution of such cases, and to avoid unnecessary litigation, it is desirable that every fire-insurance policy should provide in advance against such contingencies by setting forth a definite line of procedure. In the standard policy this is done by the following agreement: "In the event of disagreement as to the amount of loss the same shall, as above provided, be ascertained by two competent and disinterested appraisers, the insured and this company each selecting one, and the two so chosen shall first select a competent and disinterested umpire; the appraisers together shall then estimate and appraise the loss, stating separately sound value and damage, and, failing to agree, shall submit their differences to the umpire; and the award in writing of any two shall determine the amount of such loss; the parties thereto shall pay the appraiser respectively selected by them, and shall bear equally the expenses of the appraisal and umpire.

"This company shall not be held to have waived any provision or condition of this policy or any forfeiture thereof by any requirement, act, or proceeding on its part relating to the appraisal or to any examination herein provided for; and the loss shall not become payable until sixty days after the notice, ascertainment, estimate, and satisfactory proof of the loss herein required have been received by this company, in-

cluding an award by appraisers when appraisal has been required."

In interpreting this appraisal clause it should be borne in mind that the award of the appraisers is regarded as final and binding, unless it can be shown that their action involves fraud or misconduct. This is true even though the board of appraisers have not found the actual cash value of the property. The presumption is that the arbitrators must act in good faith, and while doing so errors of judgment will not invalidate the award. It is true, however, that the appraisers should limit their inquiry to the subjects submitted to them, and the award will not be sustained in case matters are considered which were not referred to them. As long as they confine themselves to the subject matter referred to them and act in good faith, they may decide questions of law as well as fact; in fact, they constitute a sort of court which has been created by the parties of the contract to settle their disagreement.

It should here be noted that while this clause is given full force in all the states of the Union, the supreme court of the state of Pennsylvania has thus far considered the appraisal clause as revokable at will by either party. The general rule in this country is that either party to the contract may insist on arbitration. In Pennsylvania, however, this is not the case. As Justice Sharwood states in his opinion given in the case of Mentz *vs.* The Armenia Fire Insurance Co. (79 Pa., 478): "There can be no doubt that if this case stood upon a general arbitration clause in the policy alone, it would fall within the principle settled by this court, conformably to all the previous English authorities, that it is not in the power of the parties to a contract to oust the courts of their jurisdiction. The cases in which the certificate or approbation of any particular person—as the engineer of a railroad company—to the amount of a claim is made a condition precedent to an action, rest upon entirely

different principles. He is not created a judge or arbitrator of law and facts, but simply an appraiser of work done. That is irrevocable. That which is before us, is a mere agreement to refer to arbitrators to be chosen at a future time.

"Such an agreement, like any other agreement of reference, is revocable, though the party may subject himself to an action of damages for the revocation. It is not in the power of the parties thus to oust the courts of their general jurisdiction, any more than they have to add to a personal covenant, that they are not to be responsible for a breach of it."

# CHAPTER XIII

## SPECIAL AGREEMENTS INDORSED ON THE POLICY

Of necessity, the standard fire-insurance policy was prepared with reference to a general situation. Yet many situations will arise where special circumstances make a modification or elimination of existing policy provisions highly desirable, or require the incorporation of new agreements not suggested in the printed portion of the policy. Such agreements take the form of printed or written indorsements on the policy, sometimes called "clauses" or "riders." When attached to the policy such indorsements take precedence over any provisions in the policy, although they may be in conflict with the same, since, being of an even or later date than the policy, they are assumed to represent the latest meeting of the minds, and thus constitute the last agreement of the parties to the contract.

Such special agreements by indorsement on the policy may, roughly speaking, be divided into two classes, viz.: (1) those especially suggested by the policy; and (2) that large variety of clauses which may be agreed upon by the parties to the contract, but which are not mentioned in the policy itself.

### INDORSEMENTS SUGGESTED BY THE POLICY

Concerning the first class, the standard fire policy contains the following very important provision (lines 11 to 30, inclusive):

"This entire policy, unless otherwise provided by agreement indorsed hereon or added hereto, shall be void if the insured now

**has or shall hereafter make or procure any other contract of insurance, whether valid or not, on property covered in whole or in part by this policy; or if the subject of insurance be a manufacturing establishment and it be operated in whole or in part at night later than 10 o'clock, or if it cease to be operated for more than ten consecutive days; or if the hazard be increased by any means within the control or knowledge of the insured; or if mechanics be employed in building, altering, or repairing the within-described premises for more than fifteen days at any one time; or if the interest of the insured be other than unconditional and sole ownership; or if the subject of insurance be a building on ground not owned by the insured in fee-simple; or if the subject of insurance be personal property and be or become incumbered by a chattel mortgage; or if, with the knowledge of the insured, foreclosure proceedings be commenced or notice given of sale of any property covered by this policy by virtue of any mortgage or trust deed; or if any change, other than by the death of an insured, take place in the interest, title, or possession of the subject of insurance (except change of occupants without increase of hazard), whether by legal process or judgment or by voluntary act of the insured, or otherwise; or if this policy be assigned before a loss; or if illuminating gas or vapor be generated in the described building (or adjacent thereto) for use therein; or if (any usage or custom of trade or manufacture to the contrary notwithstanding) there be kept, used, or allowed on the above-described premises, benzine, benzole, dynamite, ether, fireworks, gasoline, greek fire, gunpowder exceeding twenty-five pounds in quantity, naphtha, nitroglycerin or other explosives, phosphorus, or petroleum or any of its products of greater inflammability than kerosene oil of the United States standard (which last may be used for lights and kept for sale according to law, but in quantities not exceeding five barrels, provided it be drawn and lamps filled by daylight or at a distance not less than ten feet from artificial light); or if a building herein described, whether intended for occupancy by owner or tenant, be or become vacant or unoccupied and so remain for ten days."**

The foregoing policy provision enumerates various important privileges, which, if the insured wishes to enjoy them, must be indorsed on the policy. Many of these privileges require no elucidation, while that pertaining to

"other insurance" is fully discussed in another chapter. Some of these privileges, however, are variously interpreted when considered in relation to varying circumstances, and require a brief explanation. Briefly explained, they are:

1. The policy provides that the entire contract becomes void if a manufacturing establishment is operated at night later than ten o'clock, or if it ceases to be operated for more than ten consecutive days, unless expressly provided to the contrary by indorsement on the policy. This provision must be construed with reference to the nature of the business under consideration; and, according to the general ruling of the courts, will not lead to a forfeiture where there has been a temporary suspension of the business, owing to unusual and unavoidable interruptions, such as the cessation of water-power or failure to receive raw materials for manufacture.

2. The second privilege which can only be obtained by special indorsement on the policy relates to an increased hazard caused by any means within the control or knowledge of the insured. Innumerable methods of increasing the hazard subsequent to the issuance of the policy may be mentioned, such as the introduction of new customs and processes, or the discontinuance of fire-prevention precautions. This section of the policy, however, is meant to include only changes in the hazard which are of a durable rather than of a temporary character. Nor does this provision of the policy refer to changes or an increase in the hazard of adjacent buildings, since these are not within the insured's control.

3. Another very important privilege which can only be enjoyed by having it indorsed on the policy has reference to keeping within the insured premises one or more of a large number of prohibited articles, "any usage or custom of trade or manufacture to the contrary notwithstanding." This particular phraseology was adopted in order to overcome

court decisions, which held that certain of these prohibited articles were, by usage and custom, to be considered as constituting a part of a designated trade, and that the policy was issued in view of such usage and custom. Nothing could seem less ambiguous than the clause as it now stands; yet despite the qualifying phrase "any usage or custom of trade or manufacture to the contrary notwithstanding," there has been no change in the decisions of the courts in a large number of states. Three interpretations of this particular portion of the policy now prevail. In some states the provision is strictly enforced, but in other states the insertion of this qualifying phrase has no effect whatever, since the courts have held[1] that, when issuing a policy, the insurer does so with full knowledge of what constitutes a particular class of merchandise and what articles are, by custom, essential to the operation of a given business. Thus where a company (24 Ind. App., 86) insured certain described articles and "such other merchandise as is usually kept for sale in a hardware store," and provided that the entire policy should be void, "any usage or custom of trade or manufacture to the contrary notwithstanding," if there was allowed on the premises dynamite, etc., the court upheld the validity of the policy, although the property was destroyed partially by the explosion of fifty pounds of dynamite, contained on the premises, on the ground that by usage and custom dynamite was included as a part of the stock of merchandise usually kept for sale in a hardware store. In another case (111 Cal., 103) the court reasoned as follows: "A contract of insurance is to be interpreted by the same rules as is any other contract. It must be so interpreted as to give effect to the mutual intention of the parties, as it existed at the time of contracting, so far as the same is ascertainable. If it is reduced to

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[1] Phœnix Ins. Co. *vs.* Walters, 24 Ind. App., 86, 1900, and Yock *vs.* Home Mutual Ins. Co., 111 Cal., 503, 1895.

writing, the intention of the parties is to be ascertained from the writing alone. If possible, the whole contract is to be taken together; when it is partly printed and partly written, the written parts control the printed parts, and if there is any repugnancy between the two, the printed part must be disregarded. In case of uncertainty, it is to be interpreted most strongly against the party which caused the uncertainty to exist. Applying these rules to the contract in the present case, it must be held that it was the intention of the defendant to insure gasoline, for it is an article usually kept in such stores. When the defendant agreed to insure a stock of merchandise, "such as is usually kept in country stores," it must be presumed to have known the character of merchandise usually kept there."

As contrasted with the foregoing, may be mentioned the interpretation given to this clause by the supreme court of Pennsylvania. Here the attitude is not to enforce the clause in all cases, nor to give it an extremely liberal interpretation, but to take a middle position. In Pennsylvania the court has held that if the prohibited article is essential to the conduct of the business, the insurer is assumed to have knowledge of the fact, and a forfeiture of the policy will not result. On the contrary, if the evidence is such as to show that while the prohibited article is by custom and usage considered a part of a general stock of goods, but is not essential to the operation of the business, its presence on the premises will lead to a forfeiture.

4. Another privilege which the insured can only obtain by indorsement on the policy relates to the unoccupancy and vacancy of a dwelling. As observed, the standard fire policy provides that the policy becomes null and void if the dwelling, whether occupied by owner or tenant, becomes vacant or unoccupied for ten days. This is a most important provision of the policy, and it was made expressly to read, "vacant *or* unoccupied," the word unoccupied referring to those

cases where the building has been abandoned for its ordinary uses, whereas the term vacant implies not merely abandonment, but also removal of the furniture, implements, etc. Fire underwriters have thoroughly learned the lesson that vacant or unoccupied buildings are much more apt to burn than those which are inhabited and used. Not only is the moral hazard of such properties a bad one, because of their unproductivity, but the risk is greatly augmented because of the absence of any one to exercise a watchful care. Generally, however, the companies will give their consent to a vacancy by indorsing the following vacancy form:

## NEW YORK STANDARD VACANCY PERMIT

In consideration of $..... extra premium, permission is hereby granted for the premises described herein to be vacant for the period of ........ days from this ........ day of ........, 19... to the ........ day of ........, 19..., at 12 o'clock noon.

It is mutually understood and agreed between this company and the assured that the building shall be under the supervision and care of some competent person.

NOTE.--Use the above form when the contents have been removed from the building.

Attached to and forming part of Policy No. ........ of the ................ Company of .............

Agency at........................

Dated................ Agent........................

Many cases may arise where it becomes necessary to interpret the subject of vacancy or unoccupancy with reference to the use for which the property is intended. Churches and school houses, for example, are customarily vacant during the summer months, and this practice is presumed to have been understood by the insurer, so that although no vacancy permit has been secured by the insured, the policy is nevertheless considered to have been made with reference to the circumstances connected with this kind of property. The

same rule has also been applied by many of the courts to country elevators, ice manufactories, saw-mills, farm barns, etc.

5. Another group of privileges which can be obtained only by indorsement on the policy refer to the title, possession or interest of the insured in the property. Thus the entire policy is declared to be null and void, unless otherwise agreed, where the ownership of the property is not sole and unconditional, or where there has been an assignment of the policy or a change in the title, possession, or interest of the same.

That part of the clause providing against the existence of a chattel mortgage against personal property applies only to voluntary incumbrances and not to involuntary liens, such as tax liens, etc. Moreover, that portion of the policy which declares the policy null and void, if, without the consent of the insurer and with the knowledge of the insured, foreclosure proceedings be commenced or notice given of the sale of the property because of a mortgage or trust deed, would seem to indicate that it is unnecessary to mention to the insurer the existence of a mortgage on the insured premises until the foreclosure proceedings are actually commenced; in other words, that the policy applies only to the future, and is not affected by mortgages which are pending when the policy is issued.

It should also be noted that the policy stipulates that it shall become null and void if, without the consent of the insurer, any change other than by the death of the insured takes place in the interest, title, or possession of the subject of insurance, etc. This provision, to say the least, is extremely broad, and simply declares that all such changes must be brought to the attention of the company in order to give it the opportunity of canceling the policy, if it so desires. Many cases will arise where the courts must pass upon the effectiveness of certain changes in the insured's title, pos-

session, or interest, and in this connection their attitude has been heretofore that only material changes in the title or possession of the property will nullify the policy. Thus the appointment of a receiver is not considered such a change in the title or possession of the property as to lead to a forfeiture (136 U. S., 223), since receivers receive their authority from the act of the court, and the appointment is not made with a view to changing the title or right to possession, but to managing the property for the benefit of those ultimately entitled to the same. Nor will this provision be violated where there has been an execution of a contract of sale according to the terms of which the vendor retains the title until the purchaser has made all payments (142 Ill., 537).

It is a general rule, however, that the provision against the transfer or change of the insured's title is invalidated through the conveyance of an undivided interest in the property, although the amount of insurance happens to be considerably less than the remaining interest of the insured in the property (10 Mich., 279). In the case of the transfer of the property by and between partners, the ruling of the courts is by no means uniform, the rule in some states being that the policy provision is not invalidated by the sale of one partner's interest in the property to another (149 N. Y., 382; 57 Neb., 622). On the contrary, the courts of other states (47 Penna., 204) consider the sale of his interest by one partner to another as coming within the scope of this provision. In those states where a transfer of property by one partner to another is considered as not violating the policy, it is held that a change in the firm by which a third party becomes a member of the firm does constitute a violation of the policy and renders it void.[1]

[1] So many cases may arise for adjudication under that provision of the policy which provides that it shall become null and void if, without the insurer's consent, "any change other than by death of the insured takes place in the interest, title, or possession of the

### INDORSEMENTS NOT SUGGESTED BY THE POLICY

In addition to the various indorsements just described, many other kinds of special agreements in the form of indorsements exist, which are not suggested by any of the provisions in the standard fire policy. Almost any kind of special agreement may be entered into by the parties to the contract, which, when indorsed on the policy will supersede anything to the contrary in the policy, and will constitute the latest agreement. Some of these clauses have already been mentioned in other chapters, and copies of nearly all can be easily obtained from the offices of any large insurance company or brokerage firm. Frequently many of these clauses are combined in the same "rider" which is attached to the policy, and in many instances the wording of given clauses varies materially in different localities, because they are prepared by different underwriters' associations or insurance exchanges. Briefly stated, practically all of the hundreds of special clauses in use which have not been mentioned already, can be listed under one of the following five groups:

1. Those indorsements providing for an extra premium because of some deficiency in the risk, until the same has been remedied in a manner satisfactory to the company.

2. Permits for the use in certain places of certain prohibited articles, processes of manufacture, and methods of generating heat, light, and power. These permits in most cases are of a very detailed character, containing half a dozen warranties and a dozen or more "cautions" as to the proper use of the articles.

3. Prohibitory clauses, preventing the use of certain ar-

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subject of insurance, etc.," that the reader is referred to the summary of cases decided by the Supreme Court of Pennsylvania and presented in Moise and Matlack's "The Law of Insurance in Pennsylvania."

ticles and methods of generating heat, light, and power, which are not enumerated in the policy itself. As examples of such clauses in common use there may be mentioned the so-called "dynamo clause," which exempts the company from loss or damage to dynamos, switches, or other electrical appliances that may be caused by electrical currents, artificial or not, unless the same occur in consequence of fire outside of the machines themselves; the "bituminous coal clause" which exempts the company from liability for loss occasioned by the spontaneous combustion of bituminous coal on the premises of the insured; and the "consequential damage clause" which protects the company against indirect or consequential loss, including loss or damage caused by change of temperature occasioned by the destruction by fire of the refrigerating or cooling apparatus of the plant.

4. Clauses enumerating in detail the various groups of articles specifically insured under the policy, thus making unnecessary an elaborately written description of the property in the policy itself. These indorsements are usually very long, and go under captions such as "household furniture form," "automobile form," "merchandise form," "retail store form," "dwelling form," "stable form," "clothing form," "farm form," "form for building in process of construction," etc. Generally these various "forms" include other clauses which are applicable to the risk in question.

5. Special clauses according to which the company assumes extra liability, or makes a blanket policy specific with reference to certain items, or provides for the proper maintenance of fire-protection facilities, in view of which it has accepted a risk, or given a lower premium. By the so-called "cold-storage clause" the company, in consideration of an additional premium, assumes liability for loss and damage to the property within the described building caused by change of temperature resulting from the destruction or disablement of the cooling apparatus, connection or supply

pipes, etc. Similarly, under the "rent clause" the insurance company agrees to make good the loss of rents caused by fire and actually sustained by the insured on occupied or rented portions of the premises which have become untenantable during the time that is required to restore the premises as they were before the fire. Companies also, under the "live-stock clause" insure horses, cattle, and other live stock against death by lightning while in the described premises. On the other hand, certain clauses specifically limit the amount of the insurance under a given policy which is applicable to a given item of the property described, as where, for example, "not more than 15 per cent of the amount of this policy shall cover on pattern cards, drawings, designs, lithographic stones, and negatives."

Various clauses also provide for the proper maintenance of fire-protective appliances. Thus the "signaling system clause" stipulates that in view of the described premises being fully equipped with a perfect automatic fire-alarm system, etc., a reduction is made in the premium of the policy, but on the understanding that if the apparatus is at any time removed at a later date, or becomes inoperative, the company shall at once receive notice of the fact, and a pro-rata proportion of the reduction in the premium shall be refunded to the company for the unexpired term of the policy. Likewise the "automatic sprinkler clause" provides for due diligence on the part of the insured to maintain such equipment in complete working order during the term of the insurance; and the "perfect fire-protection clause" makes similar provision.

# CHAPTER XIV

## THE REINSURANCE RESERVE

THE nature and purpose of the reserve in fire insurance becomes apparent if we take into account the manner in which a company earns its premium. Thus let us suppose that a company issues an annual policy for a premium of $120. This premium is payable in advance, and since the policy has a year to run, it is clear that the company has not yet earned this sum, but will become entitled to it only in the proportion that the policy reaches its maturity. At the end of the first month one twelfth of the term has elapsed, and the company can rightfully consider that part of the premium, or $10, as earned. Eleven twelfths of the premium, however, or $110, must be considered unearned, since the company has not yet furnished protection for the eleven months remaining in the term. At the end of six months one half of the premium, or $60, is earned, and the other half unearned. It is not until the end of the twelfth month that the company has furnished the full year's insurance, and is, therefore, entitled to the full premium.

This unearned portion of the premium constitutes the reserve. It must be regarded as a sum held in trust by the company for its policy-holders. Although paid to it in advance the company cannot claim this sum as its own property. It belongs to the policy-holders, and must be earned by the company before it can be used for its own purposes. The reinsurance reserve may thus be defined as "the unearned premium"; or as the liability of the company to its policy-

holders for that portion of the premium already collected, but not yet earned.

It should be stated here that the term "reinsurance reserve," so generally used in insurance terminology, is a misnomer, and does not convey a true idea of the purpose for which a reserve exists. Certainly an insurance company does not start in business with the idea of winding up its affairs and reinsuring its business in another company. And even where a company reinsures its business, it does not at all follow, as some have argued, that the reserve should contain only that sum which would be required to reinsure its old business. Innumerable instances of reinsurance contracts exist where one company assumed the business of another company, and was willing to take considerably less than the unearned premium as the price for carrying the policies to maturity. *Vice versa*, where the company, desiring to cease business, is known to have been careless in the underwriting of its risks, the reinsuring company might demand much more than the unearned premium as the price for carrying the reinsured policies to the end of their term.

Whatever the standards may be that are advanced for the existence of a reserve, and there have been many, it will be found upon examination that all are untenable except that which regards the reserve as consisting of a sum equal to the unearned portion of the company's premium income, to be held by it in trust for the exclusive benefit of the policy-holders. In case a company becomes insolvent, the receiver or assignee would take this view of the case, and would consider each policy-holder a creditor for the unearned premium on his policy. Even in case the company reinsured its business in another company, it by no means follows that the policy-holders must consent. They can decide to withdraw, and are entitled to the unearned premium on their policies. If the company chooses, it may decide to retire from business, and no objection can be raised provided the company

makes a settlement with all its policy-holders by returning to them the unearned portion of the premium. In fact, with or without giving a reason, either party to the insurance contract may decide to cancel it, and in such a case the company must have on hand the unearned premium, because every fire-insurance contract provides that "if this policy shall be canceled as hereinbefore provided, or become void or cease, the premium having been actually paid, the unearned portion shall be returned on surrender of this policy, or last renewal, this company retaining the customary short rate, except that when this policy is canceled by this company by giving notice, it shall retain only the pro-rata premium."

From the foregoing it is evident that the maintenance by every company of a fund equal to the unearned premiums on all its policies in force should be a necessary requirement for its financial solvency. It is only natural, therefore, that the several states have enacted laws requiring all companies to maintain such a reserve, and making it the duty of the insurance commissioner to determine annually their financial condition. These laws are of the greatest importance, and upon their strict observance depends, very largely, the security of policy-holders. The law of Pennsylvania with reference to the determination of the reserve and financial solvency of the companies resembles, in its general outline, the law of other leading states, and is as follows:

"For every company doing a fire insurance business in this state, the insurance commissioner shall calculate the reinsurance reserve for unexpired fire risks, by taking fifty per centum of the premiums received on all unexpired risks that have less than one year to run, and a pro rata on all premiums received on risks that have more than one year to run; and in marine and inland insurance he shall charge all the premiums received on unexpired risks as a reinsurance reserve.

"Having charged against the company the reinsurance reserve, as above determined, for fire, inland, and marine insurance,

and adding thereto all other debts and claims against the company, he shall, in case he finds the capital stock of the company impaired to the extent of twenty per centum, give notice to the company to make good its whole capital stock within sixty days; and, if this is not done, he shall require the company to cease to do new business within this state, and shall thereupon, in case the company is organized under the authority of this state, immediately institute legal proceedings, as required in this act, to determine what further shall be done in this case. Any company receiving the aforesaid notice of the insurance commissioner, to make good its whole capital stock within sixty days, shall forthwith call upon its stockholders for such amounts as will make its capital equal to the amount fixed by the charter of said company; and in case any stockholder of said company shall neglect or refuse to pay the amount so called for, after notice personally given or by advertisement in such time and manner as the said commissioner shall approve, it shall be lawful for the said company to require the return of the original certificate of stock held by such stockholder, and in lieu thereof to issue new certificates for such number of shares as the said stockholder may be entitled to in the proportion that the ascertained value of the funds of the said company may be found to bear to the original capital of the said company, . . . ."

In its strictest sense, we have seen that the reserve of a fire-insurance company should consist of the unearned portion of all premiums collected. But when it is remembered that policies vary in their term all the way from a short period to five years, and that more policies are written at one time of the year than at another, it is apparent that it would be a difficult task to examine the thousands of policies of a large company individually with the view to determining the unearned portion of the premium for each. For all practical purposes a short cut rule may be adopted for the *approximate* ascertainment of this unearned fund. The law of Pennsylvania, already quoted, and generally applied throughout the United States, furnishes such a rule. It provides that the insurance commissioner "shall calculate the reinsurance reserve for unexpired fire risks by taking fifty per

cent of the premiums received on all unexpired risks that have less than one year to run, and a pro rata on all premiums received on risks that have more than one year to run."

This rule is only approximately correct in its application to actual conditions, since it is based on the assumption that the volume of the company's business is uniform throughout the year, i.e., that as many policies of a given term are written on the first day of the year as on the last, and that as many are written on June 30 as on July 1. If this assumption is granted, it follows that the average life of all policies written in a given year is six months, and that consequently six months of the premium is earned, while the balance is still unearned. If all the policies written by a company in a given year are one-year policies, our rule thus provides, since all these policies are assumed to have been in force six months, that the company can consider one half of the total premium income from these policies as earned, and that the other half still remains to be earned. This unearned half of the total premiums, however, which constitutes the reserve for that year on one-year policies, will be earned in the following year.

If policies are written for longer terms, such as two, three, four, and five years, the same principle is applied. Thus in the case of two-year policies the term under consideration extends over twenty-four months. It is assumed that in a given year as many two-year policies are written at the beginning of the year as at the end of the year. Consequently, all two-year policies written in that year are assumed to have been in force six months, and during the year in which the policies were written the company earns the premium in the proportion that six months bears to the total term of twenty-four months or one fourth. One fourth of the premium is, therefore, considered earned during the year in which the two-year policies were written and three fourths is still un-

earned, or in the reserve. At the end of the second year the policy is assumed to have been in existence eighteen months (six months during the first year and twelve months during the second year), and the company is now entitled to the premium in the proportion that eighteen months bears to the full term of twenty-four months, or three fourths. One fourth of the premium, however (the balance for the remaining six months of the term), is still in the reserve, and will be considered as earned in the third year.

In the case of three-year policies the term covers thirty-six months, and all such policies are again assumed to be in force for six months during the year in which they are written. Applying the same method used in the above illustration, the company earns during the year in which these policies are written, that portion of the total premium represented by the ratio of six months to the term of thirty-six months, or one sixth, while five sixths still remains to be earned. At the end of the second year the company earns another twelve months of the premium or one third of the total, and the premium is now one half earned and one half unearned. At the end of the third year the earned portion of the premium amounts to five sixths and the reserve to one sixth, and this remaining one sixth is considered earned in the fourth year. In the case of four-year policies the company earns during the year in which the policies are written one eighth of the total premium (six months out of forty-eight months) and seven eighths is in the reserve. At the end of the second year the earned premium and the reserve amount respectively to three eighths and five eighths; at the end of the third year to five eighths and three eighths; at the end of the fourth year to seven eighths and one eighth; while during the fifth year the remaining one eighth of the premium is considered earned. Similarly, in the case of five-year policies, one tenth of the premium is earned during the first year and nine tenths is in the reserve. In each succeeding year

the company earns another one fifth of the premium and the reserve decreases correspondingly, until in the sixth year the premium becomes fully earned and the reserve exhausted.

## PORTION OF PREMIUM EARNED AND UNEARNED DURING VARIOUS YEARS

| Term of Policy. | First Year. | | Second Year. | | Third Year. | | Fourth Year. | | Fifth Year. | | Sixth Year. | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Earned. | Reserve. | Earned. | Reserve. | Earned. | Reserve. | Earned. | Reserve. | Earned. | Reserve. | Earned. | Reserve. |
| 1 year | $\frac{1}{2}$ | $\frac{1}{2}$ | $\frac{2}{2}$ | 0 | | | | | | | | |
| 2 years | $\frac{1}{4}$ | $\frac{3}{4}$ | $\frac{3}{4}$ | $\frac{1}{4}$ | $\frac{4}{4}$ | 0 | | | | | | |
| 3 years | $\frac{1}{6}$ | $\frac{5}{6}$ | $\frac{3}{6}$ | $\frac{3}{6}$ | $\frac{5}{6}$ | $\frac{1}{6}$ | $\frac{6}{6}$ | 0 | | | | |
| 4 years | $\frac{1}{8}$ | $\frac{7}{8}$ | $\frac{3}{8}$ | $\frac{5}{8}$ | $\frac{5}{8}$ | $\frac{3}{8}$ | $\frac{7}{8}$ | $\frac{1}{8}$ | $\frac{8}{8}$ | 0 | | |
| 5 years | $\frac{1}{10}$ | $\frac{9}{10}$ | $\frac{3}{10}$ | $\frac{7}{10}$ | $\frac{5}{10}$ | $\frac{5}{10}$ | $\frac{7}{10}$ | $\frac{3}{10}$ | $\frac{9}{10}$ | $\frac{1}{10}$ | $\frac{10}{10}$ | 0 |

In applying the foregoing method of computing the reserve, let us assume that an insurance company begins business in the year 1907, and during the first three years receives the following premium income: During the first year $50,000 of premiums from one-year policies, $25,000 from three-year policies, and $25,000 from five-year policies; during the second year $100,000 from one-year policies, $50,000 from three-year policies, and $50,000 from five-year policies; and during the third year $200,000 from one-year policies, $150,000 from three-year policies, and $100,000 from five-year policies. Assuming that all these policies continue in force and that there are no cancellations, what should be the reinsurance reserve of this company at the end of each year?

| During the Year. | Date when Policies were Written. | Term of Policy. | Amount of Premiums Received. | Earned. | Unearned (Reserve). |
|---|---|---|---|---|---|
| 1907 | 1907 | 1 year | $50,000 | (1/2) $25,000.00 | (1/2) $25,000.00 |
| | | 3 year | 25,000 | (1/6) 4,166.67 | (5/6) 20,833.33 |
| | | 5 year | 25,000 | (1/10) 2,500.00 | (9/10) 22,500.00 |
| | | Total | | $31,666.67 | $68,333.33 |
| 1908 | 1907 | 1 year | $50,000 | (1/2) $25,000.00 | |
| | | 3 year | 25,000 | (2/6) 8,333.33 | (3/6) 12,500.00 |
| | | 5 year | 25,000 | (2/10) 5,000.00 | (7/10) 17,500.00 |
| | | Total | | $38,333.33 | $30,000.00 |
| | 1908 | 1 year | $100,000 | (1/2) $50,000.00 | (1/2) $50,000.00 |
| | | 3 year | 50,000 | (1/6) 8,333.34 | (5/6) 41,666.66 |
| | | 5 year | 50,000 | (1/10) 5,000.00 | (9/10) 45,000.00 |
| | | Total | | $63,333.34 | $136,666.66 |
| | | Total for the year. | | $101,666.67 | $167,666.66 |
| 1909 | 1907 | 1 year | $50,000 | | |
| | | 3 year | 25,000 | (2/6) $8,333.33 | (1/6) $4,166.67 |
| | | 5 year | 25,000 | (2/10) 5,000.00 | (5/10) 12,500.00 |
| | | Total | | $13,333.33 | $16,666.67 |
| | 1908 | 1 year | $100,000 | (1/2) $50,000.00 | |
| | | 3 year | 50,000 | (2/6) 16,666.66 | (3/6) $25,000.00 |
| | | 5 year | 50,000 | (2/10) 10,000.00 | (7/10) 35,000.00 |
| | | Total | | $76,666.66 | $60,000.00 |
| | 1909 | 1 year | $200,000 | (1/2) $100,000.00 | (1/2) $100,000.00 |
| | | 3 year | 150,000 | (1/6) 25,000.00 | (5/6) 125,000.00 |
| | | 5 year | 100,000 | (1/10) 10,000.00 | (9/10) 90,000.00 |
| | | Total | | $135,000.00 | $315,000.00 |
| | | Total for the year. | | $224,999.99 | $391,666.67 |

During the first year of its history this company, according to the rule adopted for reserve computations, earned one half of its $50,000 of premium income from one-year policies written during the year, one sixth of its $25,000 of in-

come from three-year policies, and one tenth of its $25,000 of income from five-year policies, or a total of $31,666.67. The reserve for the three types of policies amounted respectively to one half, five sixths, and nine tenths of the premiums received, or a total of $68,333.33.

In the year 1908 this company earns the remaining one half ($25,000) of the premiums received on the one-year policies written in 1907. It also earns two sixths of the premiums received in 1907 from the three-year policies, and two tenths of the premiums received in 1907 from the five-year policies, or a total of $38.333.33. But the company also wrote new business during 1908, receiving $100,000 from one-year policies, $50,000 from three-year policies, and $50,000 from five-year policies. Of these new premiums the company is again entitled to one half as regards one-year policies ($50,000), one sixth as regards three-year policies ($8,333.34), and one tenth as regards five-year policies ($5,000), or a total of $63,333.34. In all, the company earned during 1908 on its new business of that year and on its policies of 1907, which were still in force, a total of $101,666.67. As regards its three-year policies written in 1907, however, there remains unearned at the end of 1908 three sixths of the premium ($12,500), and as regards five-year policies seven tenths of the premium ($17,500), or a total of $30,000. By applying the proper percentages to the 1908 business, it is found that the company must keep in the reserve $136,666.66, or, in other words, the difference between the $63,333.34 earned on the 1908 business and the total premium income of $200,000 received. At the end of the second year, therefore, the company has earned a total on all the policies in force of $101,666.67, and must have in the reserve $167,666.66.

In the third year of its business (1909) our hypothetical company must make a reserve allowance for three classes of policies. Its three and five year policies written in 1907

have not yet expired; and by prorating the premium we find that at the end of the year there still remains to be earned $16,666.67 of the premiums collected in 1907 on these policies. As regards the business written in 1908, the company by the end of 1909 has only earned one half of the premiums from three-year policies and three tenths of the premiums from five-year policies, thus leaving $60,000 of premium income not yet earned. From its new business, yielding $450,000 of premiums, the company earns only $135,000 during the year in which the policies were written, and $315,000 must be assigned to the unearned premium fund. In all, therefore, the reserve at the end of the third year amounts to $391,666.67. If our illustration were extended to the fourth year, the reserve computation would be still more elaborate, because the company would then have to consider four classes of policies, viz., the three and five year policies of 1907, the three and five year policies of 1908, the one, three, and five year policies of 1909, and all the policies of 1910.

While the foregoing rule of equating the unearned premium is fairly safe for practical purposes, and meets the demands of the law, it should be remembered that it is only a system of averages, which does not always conform to real business conditions. Where a company's business is rapidly gaining, and more policies are written in the latter part of the year than in the early part, it is apparent that on the average the policies have not run for six months, and the reserve will, therefore, not be sufficiently high. *Vice versa*, if the company's business is declining, the reserve, if computed on the assumption that all policies written in the year have run six months, will be more than sufficient.

For this reason, if a large company wishes to know at any time exactly what its progress is, and whether its unearned premium liability is increasing or decreasing, it will be desirable to compute the unearned premium fund by

months instead of years. In fact, a few companies have adopted this method. Thus, in the case of one-year policies the assumption is made that as much business is done in one part of a given month as in another, and that consequently all policies written during a month may be assumed to have been in existence fifteen days. If the policy is written in January the company considers fifteen days, or one twenty-fourth of the premium earned at the end of the month, the remaining twenty-three twenty-fourths belonging to the reserve, while on the 31st of December twenty-three twenty-fourths of the premium is earned, and one twenty-fourth unearned. If the policy was written in February, three twenty-fourths of the premium will be unearned on December 31st. Similarly, as regards its three and five year business written in January, the company will consider fifteen days of premium as earned at the end of the month, while on December 31st the reserve on the three-year policies will be forty-nine seventy-secondths of the premium, and on the five-year policies ninety-seven one hundred and twentieths.

# CHAPTER XV

## COINSURANCE

UNDER the principle of coinsurance the property owner has his losses paid only in the proportion that the amount of insurance he takes out bears to the amount of insurance that the company requires him to carry. The insured is free to buy as little or as much insurance as he deems necessary, but whatever the amount may be, it is arranged that he shall recover losses from the company only in the proportion that he is willing to insure his property and pay his just share of the community's fire-insurance tax.

The New York standard coinsurance clause, or the "reduced average clause," as it is generally called, reads as follows:

"This company shall not be liable for a greater proportion of any loss or damage to property described herein than the sum hereby insured bears to ........ per centum (...%) of the actual cash value of said property at the time such loss shall happen.

"If the insurance under this policy be divided into two or more items this average clause shall apply to each item separately."

In many instances a further provision is inserted to the effect that "in case of claim for loss on the property described herein not exceeding 5 per cent (5%) of the maximum amount named in the policies written thereon and in force at the time such loss shall happen, no special inventory or appraisement of the undamaged property shall be required." This waiving of a special inventory or appraisal does in no way waive the operation of the coinsurance

clause; although it is sometimes expressly provided that the "application of the coinsurance clause shall be waived," where the aggregate amount of any loss does not exceed five per cent of the total cash value.

It is apparent from the above clause that the insurance company can designate the amount of insurance, expressed in the form of a percentage of the value of the property, which it desires the property owner to carry. Thus under a "full coinsurance clause," or for 100 per cent, the company agrees to indemnify any losses only in the proportion that the insurance actually taken out bears to the full value (100%) of the property. It is the general practice of companies, however, in well-protected cities, to require the property owner to insure his property to 80 per cent of its value. If the 80 per cent coinsurance clause is used, the company considers itself liable for only that portion of any loss resulting from fire which is represented by the proportion that the actual insurance purchased bears to the required 80 per cent. Thus if we assume the value of a building to be $20,000, then, under the 80 per cent coinsurance clause, the company will require the insured to take a policy for at least $16,000. If this is done the company agrees to pay in full any loss, not exceeding the face value of the policy. Suppose, however, that the insured decides to take only $8,000 of insurance, or one half of the required amount, and that a loss of $4,000 takes place. Under these circumstances, the coinsurance clause prevents the insured from collecting his claim in full, as he otherwise would, by providing that this $4,000 loss is to be paid only in the proportion that the insurance actually carried ($8,000) bears to the 80 per cent insurance required ($16,000), i.e., one half of $4,000, or $2,000. Since the insured elected to take only half insurance, he became, as far as any losses are concerned, coinsurer for the other half. If $10,000 of insurance had been taken, instead of $8,000, the $4,000

loss would have been paid in the proportion that $10,000 bears to $16,000, i.e., five eighths of $4,000, or $2,500. If, on the other hand, a 100 per cent, or full coinsurance clause had been used, and only $8,000 of insurance taken, the property owner would have had his loss paid in the proportion that $8,000 bears to $20,000 (the full value of the property) i.e.: to the extent of two fifths of $4,000, or $1,600.

The adoption of the coinsurance principle is absolutely essential to secure justice between property owners, and to enable the company to collect premiums from all, commensurate with the risk assumed. It is a well-known fact that in cities with good fire protection only about one out of every twenty fire losses is a total one, many of the remaining nineteen losses being only nominal in amount. Thoroughly appreciating this fact, many property owners are willing to run the chance of carrying a small amount of insurance, thus paying a proportionately small premium, with the hope that their policies will be large enough to cover their partial loss, if any should occur. The total fire waste, however, is not in the least diminished, and the insurance companies must collect the same aggregate premium income to meet their claims. The result is that those property owners who do not wish, or because of credit obligations cannot afford, to gamble with chance, and must insure their property to nearly its full value, are obliged to pay a much larger premium when compared with the losses they suffer during a given period of time, since they help to pay the many partial losses of those numerous owners who shirk the payment of their just portion of the fire tax. Let us assume two persons, each owning a house valued at $10,000, and that the premium rate is 1 per cent. Let us also assume that one of these owners insures his property to the extent of $8,000, but that the other owner, knowing that the great majority of losses are partial and relatively small, decides to take chances

with a $2,000 policy. At a rate of 1 per cent the first owner pays a premium of $80, and the second only $20. Now let us assume that both owners suffer a loss of $2,000. In case there were no coinsurance both owners would receive their $2,000, although one paid four times as large a premium as the other.

Again, to use an excellent illustration of the unfairness of issuing policies without incorporating the coinsurance principle, let us assume that "'A' and 'B' each own a half interest in a building having a present structure value of $20,000. Each insures his half interest separately and in different companies; each company charges the same percentage or 'rate' for insuring the property, and that 'rate' is 1 per cent, or $10 for $1,000 of insurance. 'A' insures his half in the 'Y' company for $10,000, and pays for his policy $100. 'B' insures his half in the 'Z' company for $5,000, and pays for his policy $50. A fire occurs and the building is damaged to the extent of $10,000 only. Company 'Y,' insuring 'A,' is called on to pay but 50 per cent of the amount of its policy, while company 'Z' pays 100 per cent; and yet company 'Y' received twice as much premium as did company 'Z.'"[1]

The above illustrations demonstrate that a disregard of the coinsurance principle results in a grave injustice to those who do not desire to run the risk of taking partial insurance, and who, in consequence, pay premiums out of all proportion to the benefits received. The coinsurance clause, however, remedies this injustice by providing that every property owner shall have his losses paid only in the proportion that he is willing to pay a premium. In our first illustration one of the owners was willing to pay only one fourth as

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[1] Illustration furnished by President Evans of the Continental Fire Insurance Company and published in F. C. Moore's "Fire Insurance and How to Build," p. 577.

much premium as the other, who was willing to pay the premium required of the community in general. Justice demands that he should receive in the proportion that he was willing to pay premiums, and accordingly is entitled to only one fourth of his loss, or $500.

But coinsurance serves another very useful purpose in protecting property owners against the efforts of great industrial and mercantile corporations to shirk the payment of their just share of premiums. In most large mercantile and manufacturing plants it will be found that the property is either situated in different localities, or that the contents of a given building are stored in different compartments, each separated from the other by fireproof walls, or at least so protected that in the great majority of cases the fire can be easily confined to the compartment where it originated. Under such circumstances a total loss is hardly to be expected, and no one realizes this better than the property owner. Thus, let us assume that a merchant is the owner of two stocks of goods, situated in two localities, "A" and "B," and worth, respectively, $10,000 and $5,000. If these two stocks of goods are situated so far from each other that from a fire-insurance standpoint neither is affected by the other, it is apparent that, if permitted, the merchant could fully protect himself by taking out a blanket policy of $10,000, covering both items, since his loss could not exceed this amount, except under the most unusual event of a fire occurring in both properties at the same time. In other words, $15,000 worth of property would be effectually covered by $10,000 of insurance.

No insurance company could afford to insure the property of large concerns in this way, and so until comparatively recent years it was the general practice of American companies to require a specific amount of insurance on each isolated compartment. Soon, however, it became evident that many property owners were suffering an injustice through

the requirement for specific insurance. While buildings could be easily insured under different policies, it was impossible for the merchant to know in advance how much insurance he would require on the contents in given buildings or compartments, since the amount of his stock in different localities was constantly changing, and his books could not be kept in such a way as to show the value in each locality. The manufacturer also complained that in the process of manufacture his property moved from hour to hour, from one compartment to another, and that it was impossible to keep track of the value of the property in different parts of the factory.

So in one line of business after another there arose a demand for insurance written in such a way as to insure against loss resulting from the origin of a fire in any part of the establishment. To meet this need the companies began to issue blanket policies covering the entire property. But to prevent the owner from securing full protection for all the items of property by simply taking out a policy equal in amount to the value of the most valuable item, the companies issued the blanket policy "with coinsurance"; according to which the insured agreed to keep his property insured for 80 per cent of its value; and, in case this was found not to have been done, his losses were to be paid only in the proportion that the amount of insurance he carried bore to the 80 per cent of value required.

Where property is thus distributed over several items and changes its location from time to time, the interests of both insured and insurer are protected by the use of the "distribution form" of the coinsurance clause. The adjustment of losses under this plan will become clear if we revert to our last illustration, where a merchant is the owner of two stocks of goods, situated in two localities, "A" and "B," and worth respectively $10,000 and $5,000. Let us assume that these two items are insured this time under a blanket

policy of $10,000, with an 80 per cent coinsurance clause, and that a loss of $2,000 occurs in "A."

In determining the liability of the insurance company, it should be stated that the distribution form of the coinsurance clause automatically distributes the blanket policy at the time of the fire in such a manner that each separate item is covered in the proportion that the value of that item bears to the combined value of all the items. Since, in the above illustration the merchant saw fit to carry a blanket policy of only $10,000 on two items of property worth $15,000, it follows from the above rule that the property in "A" is only covered by the $10,000 blanket policy in the proportion that its value ($10,000) bears to the combined value of both items ($15,000), i.e., to the extent of two thirds of $10,000, or $6,666.66. If no provision had been made for coinsurance, the $2,000 loss in "A" would be paid in full, since $6,666.66 of insurance is available. But in this case the blanket policy was written with 80 per cent coinsurance, and the merchant was thus required to insure his $15,000 worth of property in "A" and "B" to the extent of 80 per cent of the value, or $12,000. Since he took out only $10,000 worth of insurance, his loss of $2,000 in "A" will be paid only in the proportion that his policy of $10,000 bears to the required insurance ($12,000), or five sixths, making the claim $1,666.66.

The fairness of coinsurance as a means of establishing equitable rates is so well recognized that in practically all parts of Europe the agreement is invariably used, and in many countries, like France, Italy, Spain, Portugal, and Belgium, is made compulsory by law. The principle has also been used in marine insurance from the earliest times. In the United States, however, it was not until about 1890 that a serious attempt was made to apply coinsurance generally to fire policies. Even to-day the vital importance and inherent justice of the practice are not appreciated in many

sections of the country. No less than ten states now have so-called anti-coinsurance laws upon their statute books. The recent law of Louisiana (chapter 187, passed in 1908) may be cited as an illustration. It reads: "No insurance policy hereafter issued by any insurance company authorized to do business in this state shall contain any clause or provision requiring the insured to take out or maintain a larger amount of insurance than that covered by such policy, nor in any way providing that the insurer shall be liable as coinsurer with the company issuing the policy for any part of the loss or damage which may be occasioned by fire, lightning, or wind-storm, to the property located in this state, covered by such policy, nor making provisions for a reduction of such loss or damage by reason of failure of the assured to take out and maintain other insurance upon said property."

Legislation of this sort shows a woeful ignorance of the true relation of fire insurance to the business community, and deliberately puts it in the power of large business concerns, with scattered property interests, to shift a large share of their fire tax upon the small property owner. It overlooks the fact that the application of the coinsurance principle must be likened to the application of a government tax. Fire insurance, as already noted, is a tax paid by all the property owners of the community for the purpose of indemnifying unfortunate losers. In form it resembles a general property tax, except that it is collected and disbursed by private companies instead of by the government. As the government tax, to be equitable, is paid by the owners of property in proportion to the value of the same, so the fire-insurance tax, to be equitable, should also be based upon the value of the property owned, and not according to what the insured may choose to pay. As every state and municipality adopts a uniform method of assessment in levying its tax with a view to preventing discrimination, so in fire insurance

the same uniformity of assessment should prevail, and the same effort should be made to prevent discrimination between the small and the large owner, or between those who insure partially and those who insure fully. Evasion in the payment of the fire tax should be regarded as no less unjust than the evasion of government taxes.

*Graded Rates for Coinsurance.*—But it will be asked why should a property owner be compelled to take out a certain amount of insurance, when he insists on having less? Conceding that he does an injustice to other property owners by taking out too little insurance, is there not a way of giving the insured what he wishes, and at the same time make him contribute an amount which will correctly compensate for the injustice which he has done? The answer is that there is no reason why the effect of coinsurance might not be realized just as well by grading the rates according to the amount of insurance carried, and then paying all losses in full, as by keeping the rate the same, no matter what the amount of insurance, and then paying all losses only in the proportion that the insurance taken out bears to the required 80 per cent. Mathematically, the two plans can be made to equal each other. The plan of grading rates, according to the amount of insurance, however, will have the advantage of eliminating the compulsory feature which has aroused so much antagonism from owners and legislators.

The framers of the "Standard Universal Schedule for Rating Mercantile Risks," recognized the importance, from the standpoint of policy, of not insisting upon 80 per cent insurance. This schedule is so arranged that the insured can take as much or as little insurance as he pleases. The rate charged, however, is adjusted to whatever amount of insurance the insured elects to take.

The rule adopted in the Universal Mercantile Schedule provides for "a deduction of ½ of 1 per cent for each per cent of coinsurance in excess of 50 per cent, not exceeding 15

per cent in all; and an addition of 1 per cent for each per cent that the insurance is less than 50 per cent of the value." In other words, the property owner is given the flat rate as determined by the schedule if he insures his property to 50 per cent of its value. But let us suppose that he insures the property to 80 per cent of its value to comply with the 80 per cent coinsurance clause; in that case he will have his rate reduced by ½ of 1 per cent for each per cent of insurance over and above 50 per cent of the value. He takes out 30 per cent more insurance than the required 50 per cent, and will, therefore, have his rate reduced by 15 per cent. If, on the contrary, he decides to insure his property to only 20 per cent of its value, then his rate will be increased by 1 per cent for every per cent of insurance less than the required 50 per cent. The insurance he takes is 30 per cent less than the required 50 per cent, therefore he will have his rate increased by 30 per cent. Thus, if we assume that the rate as determined by the schedule is 100 cents, or 1 per cent, this rate is charged if the insurance equals 50 per cent of the value; if 80 per cent insurance is taken, the rate, according to the above rule, will be only 85 cents, whereas, if only 20 per cent insurance is taken, the rate will be $1.30. In other words, according to this method, the rates are so graded that the company will make as much money when the property is insured to 50 per cent of its value, as though it were insured to 80 per cent or 100 per cent.

The adoption of the rule of deducting ½ per cent for each 1 per cent of coinsurance in excess of 50 per cent of the value of the property, as explained by Mr. F. C. Moore in his "History and Analysis of the Universal Mercantile Schedule," [1] is based upon the actual experience of the companies. This experience, we are informed, shows that "68

[1] F. C. Moore, "Fire Insurance and How to Build," pp. 709, 710.

per cent of the losses in number are under $100 in amount; 15 per cent are over $100, and under 25 per cent of the value of the property; 7 per cent in number are between 25 and 50 per cent; 5 per cent between 50 and 80 per cent, and 5 per cent total." In illustrating the approximate justice of the above rule of grading premiums according to the amount of insurance taken, Mr. Moore assumes 10,000 risks valued at $1,000 each, and insured to 50 per cent of the value, or $500, at a rate of 1 per cent, and showing a loss experience of 200 losses, amounting to $27,500, or 55 per cent of the premiums. Then, by applying the above mentioned experience Mr. Moore constructs the following table, "showing the distribution of losses and premiums. (The column headed 'Value Loss,' would show the estimated amount of loss or damage to the property based upon the tabulated Company experience.)" [1]

| No. of Risks. | No. of Losses | Per Cent of Loss to Value. | Value Loss. | Ins. Loss with 50% Ins. | Ins. Loss with 70% Ins. | Ins. Loss with 80% Ins. | Ins. Loss with 100% Ins. |
|---|---|---|---|---|---|---|---|
| 10,000 | 136 | Under $100 | $3,500 | $3,500 | $3,500 | $3,500 | $3,500 |
| 10,000 | 30 | $100 to 25% | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 |
| 10,000 | 14 | 25% to 50% | 7,000 | 7,000 | 7,000 | 7,000 | 7,000 |
| 10,000 | 10 | 50% to 80% | 7,500 | 5,000 | 7,000 | 7,500 | 7,500 |
| 10,000 | 10 | Total or 100% | 10,000 | 5,000 | 7,000 | 8,000 | 10,000 |
| 10,000 | 200 | | $35,000 | $27,500 | $31,500 | $33,000 | $35,000 |
| Rate | | | | 1% | 90 cts. | 85 cts. | 75 cts. |
| Amt. of Premiums (10,000 risks) | | | | (*a*) $50,000 | (*b*) $63,000 | (*c*) $68,000 | (*d*) $75,000 |

(*a*) 10,000 risks insured for 50 per cent of value, or $500 each, at 1 per cent, would yield $50,000 premiums. On this amount of premium the insurance loss ($27,500) would be just 55 per cent.

(*b*) 10,000 risks insured for 70 per cent of value, or $700 each,

[1] F. C. Moore, "Fire Insurance and How to Build," p. 710.

at 90 cents (100 minus 10 per cent, being a reduction in rate of ½ per cent for each 1 per cent of insurance in excess of 50 per cent, i.e., 20 per cent), would yield a premium of $63,000. On this amount of premium the insurance loss ($31,500) would be just 50 per cent.

(*c*) 10,000 risks insured for 80 per cent of value, or $800 each, at 85 cents (100 minus 15, being ½ per cent reduction for each 1 per cent of the 30 per cent, which 80 per cent insurance is in excess of 50 per cent), would yield $68,000 premium. On this amount of premium the losses ($33,000) would be safely within 50 per cent.

(*d*) 10,000 risks insured for 100 per cent of value, or $1,000 each, at 75 cents (being a reduction of 25 per cent, or ½ of 1 per cent for each 1 per cent of the 50 per cent which 100 per cent exceeds 50 per cent), would yield $75,000 in premiums.[1]

*Coinsurance as Applied to the Rating of Fireproof Buildings.*—In rating fireproof buildings it is of the greatest importance to take into account the amount of insurance carried. Experience has shown that only about 15 per cent of the value of a fireproof building, covering wooden trimmings, fresco work, plate glass, etc., is susceptible to destruction by fire. It consequently follows that if such a building is insured for only 15 per cent of its value, the rate should be approximately the same as that charged on a non-fireproof building. In rating fireproof structures the Universal Mercantile Schedule adopts a rule to the effect that if the owner insures the building to the extent of 15 per cent of its value, he shall pay the flat rate as found up to the point where allowance is made for coinsurance. If, however, a building is insured to more than 15 per cent of its value, a deduction is made from the flat rate because of the existence of extra insurance.

The reasoning which underlies the reduction in rates on fireproof structures in case more than 15 per cent of the

[1]Table from F. C. Moore's "Fire Insurance and How to Build," p. 710.

value of the building is insured, may be illustrated as follows:[1] Assume a fireproof building worth $1,000,000, and assume further that the rate for the minimum amount of insurance (15 per cent) is 100 cents, or 1 per cent. The premium for $150,000 of insurance, or 15 per cent of the value, would, therefore, be $1,500. Now, if the owner of the property agrees to carry $200,000 of insurance, or 20 per cent of the value of the building, instead of only 15 per cent, the additional $50,000 insurance can be accepted by the underwriter at much less than was charged for the first $150,000. He knows that the additional $50,000 of insurance cannot become available to the insured until the first $150,000 has been exhausted, and this last sum is assumed to cover nearly all losses, since only 15 per cent of the value is considered destructible. In the same manner a lower rate could be given for each succeeding $100,000 of additional insurance, because the larger the amount of insurance the less likelihood is there of all this insurance becoming available for the payment of losses.

The plan adopted in the Universal Mercantile Schedule for fireproof buildings is to charge a rate for the first $100,000 of excess insurance equal to only 40 per cent of the rate for the first $200,000 of insurance. Each succeeding $100,000 of insurance is granted at a rate 5 per cent less than the rate granted on the preceding $100,000 of insurance. The reduction thus given for each $100,000 of extra insurance is illustrated by the following table, which was computed upon the hypothetical example of a million-dollar building with a rate equal to 100 cents in case only 15 per cent insurance was taken out:[2]

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[1] For a full discussion of this subject see F. C. Moore's "Fire Insurance and How to Build," p. 712.

[2] The following table is presented in F. C. Moore's "Fire Insurance and How to Build," p. 713.

| Percentage Insured. | Percentage of preceding rate charged for next $100,000 of Ins. | Amount Insured. | Rate. | Premium. |
|---|---|---|---|---|
| 15% | 100 % | $150,000 | 100.0 cents | $1,500 |
| 20% | 45 % | 200,000 | 86.3 " | 1,725 |
| 30% | 40 % | 300,000 | 69.0 " | 2,070 |
| 40% | 35 % | 400,000 | 57.8 " | 2,312 |
| 50% | 30 % | 500,000 | 49.7 " | 2,485 |
| 60% | 25 % | 600,000 | 43.5 " | 2,610 |
| 70% | 20 % | 700,000 | 38.5 " | 2,695 |
| 75% | 17.5% | 750,000 | 36.4 " | 2,732 |
| 80% | 15 % | 800,000 | 34.4 " | 2,710 |
| 90% | 10 % | 900,000 | 30.9 " | 2,785 |
| 100% | 5 % | 1,000,000 | 28.0 " | 2,800 |

A brief explanation of this table may be necessary. Taking the first line of the table, if the owner of a fireproof building worth $1,000,000 insures 15 per cent of its value, the amount of insurance will equal $150,000. The rate we assumed, and as found according to the schedule, is 100 cents per $100 of insurance, or 1 per cent, and the total premium paid by the owner is $1,500. Suppose, now, that the property owner agrees to insure 20 per cent of the value of his building. According to the table, the Universal Mercantile Schedule will permit the extra $50,000 to be taken out at a rate equal to only 45 per cent of the rate on the preceding $150,000 of insurance. The problem now is to compute the rate on $200,000 of insurance. This may be done in the following way: The $150,000 of insurance we saw required a premium of $1,500. Now the extra $50,000, or the sum over and above 15 per cent, was granted at a rate equal to only 45 per cent of the preceding rate, i.e., 45 per cent of 100 cents, or 45 cents. A rate of 45 cents per $100 of insurance for the extra $50,000 of insurance will give a total premium of $225. The total amount of the premium, therefore, for $200,000 of insurance equals $1,500 plus $225, or $1,725. The rate for the $200,000 policy, therefore, equals $1,725 divided by $200,000, or 86.3 cents.

Suppose, now, that the property is insured for 30 per cent of its value, or $300,000. According to the Universal Mercantile Schedule the extra $100,000 of insurance is granted at a rate equal to only 40 per cent of the rate, or 86.3 cents, on the preceding $200,000. The total premium on $300,000 of insurance would, therefore, amount to the premium on the $200,000 of insurance ($1,725), plus 40 per cent of the preceding rate (that is to say, 40 per cent of 86.3 cents), or 34.5 cents for the extra $100,000, or $345, thus giving a total of $2,070. The rate for $300,000 of insurance is found by dividing $2,070 by $300,000, which gives 69 cents. The same method of computation may be used for calculating the rate for additional insurance to any amount, until finally the entire building is insured, which, if done, will require a rate equal to only 28 per cent of the rate required by the schedule if the building is insured to only 15 per cent of its value.

Now it is advisable that a further table be devised which will enable the rater to know at once (being given the percentage of the value insured, and the rate as determined by the schedule) what the rate on the given policy shall be. This table is arranged as follows in the Universal Mercantile Schedule: "For insurance not exceeding 15 per cent of the value of building, charge full rate obtained by the Schedule at No. 324. For any percentage of value in excess of 15 per cent take the following percentage of the rate, viz.: for 20 per cent of value, 86 per cent of the rate; for 30 per cent, 69 per cent of the rate; for 40 per cent, 58 per cent of the rate; for 60 per cent, 44 per cent; for 70 per cent, 39 per cent; for 75 per cent, 36½ per cent; for 80 per cent, 34 per cent; for 90 per cent, 31 per cent; for 100 per cent, 28 per cent. The following table will show the proper rate for any percentage of coinsurance: [1]

[1] The following table is found in the rating slip for rating fireproof buildings according to the Universal Mercantile Schedule.

## COINSURANCE ON FIREPROOF BUILDINGS

| Rate No. 324 of Universal Schedule | Percentage of Insurance to Value. | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 20% | 30% | 40% | 50% | 60% | 70% | 75% | 80% | 90% | 100% |
| Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents | Cents |
| 15 | 12.95 | 10.35 | 8.67 | 7.45 | 6.52 | 5.77 | 5.46 | 5.16 | 4.63 | 4.20 |
| 16 | 13.81 | 11.04 | 9.24 | 7.95 | 6.96 | 6.16 | 5.82 | 5.50 | 4.94 | 4.48 |
| 17 | 14.67 | 11.73 | 9.82 | 8.44 | 7.39 | 6.54 | 6.18 | 5.84 | 5.25 | 4.76 |
| 18 | 15.53 | 12.42 | 10.40 | 8.94 | 7.83 | 6.93 | 6.55 | 6.19 | 5.56 | 5.04 |
| 19 | 16.39 | 13.11 | 10.98 | 9.44 | 8.26 | 7.31 | 6.91 | 6.53 | 5.87 | 5.32 |
| 20 | 17.26 | 13.80 | 11.56 | 9.94 | 8.70 | 7.70 | 7.28 | 6.88 | 6.18 | 5.60 |
| 21 | 18.12 | 14.49 | 12.13 | 10.43 | 9.13 | 8.08 | 7.64 | 7.22 | 6.48 | 5.88 |
| 22 | 18.98 | 15.18 | 12.71 | 10.93 | 9.57 | 8.47 | 8.00 | 7.56 | 6.79 | 6.16 |
| 23 | 19.84 | 15.87 | 13.29 | 11.43 | 10.00 | 8.85 | 8.37 | 7.91 | 7.10 | 6.44 |
| 24 | 20.71 | 16.56 | 13.87 | 11.92 | 10.44 | 9.24 | 8.73 | 8.25 | 7.41 | 6.72 |
| 25 | 21.57 | 17.25 | 14.45 | 12.42 | 10.87 | 9.62 | 9.10 | 8.60 | 7.72 | 7.00 |
| 26 | 22.43 | 17.94 | 15.02 | 12.92 | 11.31 | 10.01 | 9.46 | 8.94 | 8.03 | 7.28 |
| 27 | 23.30 | 18.63 | 15.60 | 13.41 | 11.74 | 10.39 | 9.82 | 9.28 | 8.34 | 7.56 |
| 28 | 24.16 | 19.32 | 16.18 | 13.91 | 12.18 | 10.78 | 10.19 | 9.63 | 8.65 | 7.84 |
| 29 | 25.02 | 20.01 | 16.76 | 14.41 | 12.61 | 11.16 | 10.55 | 9.97 | 8.96 | 8.12 |
| 30 | 25.89 | 20.70 | 17.34 | 14.91 | 13.05 | 11.55 | 10.92 | 10.32 | 9.27 | 8.40 |
| 35 | 30.20 | 24.15 | 20.23 | 17.39 | 15.22 | 13.47 | 12.74 | 12.04 | 10.81 | 9.80 |
| 40 | 34.52 | 27.60 | 23.12 | 19.88 | 17.40 | 15.40 | 14.56 | 13.76 | 12.36 | 11.20 |
| 45 | 38.83 | 31.05 | 26.01 | 22.36 | 19.57 | 17.32 | 16.38 | 15.48 | 13.90 | 12.60 |
| 50 | 43.15 | 34.50 | 28.90 | 24.85 | 21.75 | 19.25 | 18.20 | 17.20 | 15.45 | 14.00 |
| 55 | 47.46 | 37.95 | 31.79 | 27.33 | 23.92 | 21.17 | 20.02 | 18.92 | 16.99 | 15.40 |
| 60 | 51.78 | 41.40 | 34.68 | 29.82 | 26.10 | 23.10 | 21.84 | 20.64 | 18.54 | 16.80 |
| 65 | 56.09 | 44.85 | 37.57 | 32.30 | 28.27 | 25.02 | 23.66 | 22.36 | 20.08 | 18.20 |
| 70 | 60.41 | 48.30 | 40.46 | 34.79 | 30.45 | 26.95 | 25.48 | 24.08 | 21.63 | 19.60 |
| 75 | 64.71 | 51.75 | 43.35 | 37.26 | 32.61 | 28.86 | 27.30 | 25.80 | 23.17 | 21.00 |
| 80 | 69.04 | 55.20 | 46.24 | 39.76 | 34.80 | 30.80 | 29.12 | 27.52 | 24.72 | 22.40 |
| 85 | 73.35 | 58.65 | 49.13 | 42.24 | 36.97 | 32.72 | 30.94 | 29.24 | 26.26 | 23.80 |
| 90 | 77.67 | 62.10 | 52.02 | 44.73 | 39.15 | 34.65 | 32.76 | 30.96 | 27.81 | 25.20 |
| 95 | 81.98 | 65.55 | 54.91 | 47.21 | 41.32 | 36.57 | 34.58 | 32.68 | 29.35 | 26.60 |
| 100 | 86.30 | 69.00 | 57.80 | 49.70 | 43.50 | 38.50 | 36.40 | 34.40 | 30.90 | 28.00 |

N. B.—For any intermediate rate, combine two of above; for example, the rate of 31 cents would be that for 15 cents and 16 added; the rate for 32 would be double that for 16.

If the rate, as found by the schedule, is 15 cents per hundred dollars of insurance, this means that the flat rate of 15 cents is to be charged if only 15 per cent of the value is insured. But let us assume that 20 per cent of the value of the building

is insured. In that case we saw from the preceding table that the rate is to be 86.3 per cent of the flat rate instead of the full rate, or 100 per cent. But 86.3 per cent of 15 cents is 12.95 cents, and that is the figure which will be found in the column under the 20-per-cent heading and opposite the 15-per-cent rate. Suppose that with the flat rate being 15 cents the policy-holder agrees to insure the building to 30 per cent of its value. In the preceding table we noticed that if 30 per cent of the value of the building is insured the rate shall be only 69 per cent as large as if only 15 per cent of the building were insured. Sixty-nine per cent of 15 cents is 10.35 cents, which is the amount which will be found opposite the fifteen cents rate and in the 30-per-cent column. The same explanation might be given for any rate found by the schedule and for any amount of insurance that might be taken out. Thus, for example, if the rate found by the schedule is 28 cents, this rate is the rate which is to be charged if only 15 per cent of the value of the building is insured, that is to say, 100 per cent of the rate is charged if the insurance amounts to only 15 per cent of the value of the building. Suppose, however, that the owner of the building agrees to insure 50 per cent of the building. The preceding table shows that if 50 per cent of the value is insured, the rate should be only 49.7 per cent of the rate charged if only 15 per cent of the value is insured, that is to say, 49.7 per cent of 28 cents, or 13.91 cents. This is the amount which will be found in the 50-per-cent column opposite the 28-cent rate.

*The Three-Quarters Loss and Value Clauses.*—It should be noted that fire-insurance policies frequently contain a clause which limits the insurer's liability to a fixed proportion, such as two thirds or three fourths of the loss, or of the value of the property insured. In cities with good fire protection, it is the desire of the company to prevent the insured from taking out too little insurance. On the other hand, in communities where the fire-protection facilities are poor,

and where losses are apt to be total rather than partial, or in the case of properties which may at any time become unprotected, or which are dangerous risks, it is the desire of the company to assure itself of the owner's interest in safeguarding the property by preventing him from taking out too much insurance. Thus, if a building is valued at $10,000 at the time of the fire, and is insured under an $8,000 policy containing a "three-fourths loss clause," and the loss amounts to $8,000, then the company's liability is limited to three fourths of $8,000, or $6,000. If, however, this $8,000 policy contained a "three-fourths value clause," the company's liability would be three fourths of $10,000, or $7,500. The following two clauses are given as typical examples of the "three-fourths" clause:

### THREE-FOURTHS VALUE CLAUSE

It is a condition of this insurance that, in the event of loss or damage by fire to the property insured under this policy, this company shall not be liable for an amount greater than three fourths of the actual cash value of each item of property insured by this policy (not exceeding the amount insured on each such item) at the time immediately preceding such loss or damage; and in the event of additional insurance—if any is permitted hereon—then this company shall be liable for its pro rata proportion only of three fourths such cash value of each item insured at the time of the fire, not exceeding the amount insured on each such item.

Attached to and made a part of Policy No. ............ of ................ Insurance Company.

### THREE-FOURTHS LOSS CLAUSE

It is a condition of this insurance that, in the event of loss under this policy, this company shall not be liable for an amount greater than three fourths of such loss (not exceeding the sum hereby insured), and in the event of additional insurance permitted hereon, then this company shall not be liable for an amount greater than its pro rata proportion of three fourths of such loss; in both events the other one fourth to be borne by the assured.

Attached to and made a part of Policy No. ............ of ................ Insurance Company.

Many believe that the supposed benefits of a seventy-five-per-cent limit of insurance to value or loss are greatly exaggerated, and doubt its efficacy in the case of movable property. In this class of property it is frequently impossible to estimate correctly the value of stocks in sealed barrels, boxes, bottles, or packages, and while a dishonest owner may receive but three fourths of his dishonest claim, this three fourths of the loss may greatly exceed the entire value of the stock. In the case of buildings, however, which can be correctly valued, the owner should have a one-fourth interest in their protection, and the three-fourths clause may here serve a useful purpose.

# CHAPTER XVI

## FIRE-INSURANCE RATING

THE fire waste in the United States averages annually about $200,000,000. This huge sum is gone forever, and cannot be replaced through insurance or any other means. Fire insurance is not directly productive, but the good it produces is purely negative in character. Its sole object is to distribute among all members of the community those losses through fire sustained by the individual, and its cost must therefore be regarded in the nature of a tax assessed against the many for the benefit of the unfortunate few. It is the task of fire-insurance companies to equitably assess, collect, and distribute this tax.

In all ages the task of the tax gatherer has been an unpleasant one, and the work of properly assessing taxes has always been one of the most difficult problems of government. The fire tax is no exception to this rule. Against its assessors and collectors—the insurance companies—there has been directed for years a vast amount of unfriendly criticism. Just as with other taxes, there is a constant endeavor to lessen the individual burden without, however, lessening the actual fire waste. So many factors, however, enter into the making of the fire rate, and so little does the average property owner understand why he is charged a certain sum, that the whole subject of "fire rating" has come to be regarded by the public as shrouded in mystery, marked by inconsistencies, and indeed as little more than pure guess work. Whenever many independent companies are seen to charge the same rate for the same class of risks, it is only

natural, in view of the general ignorance on the subject, to hear the cry everywhere that the competing companies have formed a combine in restraint of trade. Every time some company or agent shows contempt for established rates and departs widely from the same, one hears on every hand about the "guesswork" in rate-making.[1]

Such instances of flagrant departure from established rates, however, are the exception, and fail utterly to show how the vast business of fire insurance in the United States is actually conducted to-day. As Mr. A. F. Dean so ably states in his "Rationale of Fire Rates": "Competitive conditions of this kind are so rare that they have no appreciable effect upon the aggregate business of the country. They have about as much influence upon average results as a shooting scrape or street brawl might have on the loss ratio of the accident companies. Where a rate war extends to an entire state, it may determine the retirement of a weak company or two at the end of the year; but, as a whole, it simply serves to increase the average cost ratio of the country by a small percentage. That these things should create the inference that fire rates are the result of pure conjecture is natural, but the inference is false. The fire rate is the farthest possible removed from guesswork. In point of equitable distribution, it puts to shame the taxes assessed by our municipalities, states, or even the National Government. As a system, it is more carefully thought out, more elabo-

[1]For further discussion of the subject of rate making in fire insurance, see the following: F. C. Moore, "Fire Insurance and How to Build;" "The Standard Universal Schedule for Rating Mercantile Risks," edition of January, 1902; A. F. Dean, "Fire Rating as a Science," Chicago, 1901; A. F. Dean, "The Rationale of Fire Rates," Chicago, 1901; Richard M. Bissell, "Rates and Hazards," a lecture published in the Yale Insurance Lectures; Charles A. Hexamer, "Rates and Schedule Rating," in the Annals of the American Academy, September, 1905.

rate, more logical, and more just than any governmental system of taxation. As a tax, it is assessed so close to aggregate cost that for long periods the residuum of underwriting profit is hardly more than an ordinary brokerage."

*The Nature of the Hazard in Fire Insurance.*—Why rate-making in fire insurance should have attained this carefully thought out and logical character becomes clear when we reflect how numerous are the elements which make up the hazard to which insured property is subject. Ordinary intelligence will recognize at once the difference between a cotton mill and a brick dwelling from the standpoint of fire hazard; and such distinctions exist between a thousand different types of property. Again, taking two risks within the same class, let us say cotton mills, one may be of wooden construction, a perfect tinder-box without any of the modern devices for preventing and extinguishing fires; the other of brick construction, with boilers and dangerous processes in separate buildings or compartments, and equipped with all the latest protective appliances. To charge the same rate on both mills would be an act of the grossest injustice, and would simply be overcharging the owner of the best mill for the benefit of the other. In other words, to treat the community justly, that is to say, charge "like rates to like hazards," the fire-insurance companies are obliged to distinguish not only between the numerous classes of property, but also between the individual risks of each class.

To carry the illustration further, each building of a given class is surrounded by an environment peculiar to itself. One factory or store may be far removed from other dangerous risks; another may be situated in the very center of a congested conflagration district. One may be in a city with poor fire-extinguishing facilities, while the other has the benefit of a first-class fire department. As a matter of fact, with reference to fire-extinguishing apparatus, some rating

schedules divide cities into as many as six classes, according to the degree of efficiency. The most limited intelligence will at once perceive that a distinction must here be made if justice in rating is to be secured.

Again, with reference to a particular type of building, such as stores, for example, there exist a thousand possible hazards of occupancy. Of several buildings of like construction, one may be used as a dry goods store, another as a hardware store, a third as a drug store, etc. The buildings may be alike in construction, environment, and every other particular, yet the danger of destruction by fire to these buildings is different, because of the different substances which they contain and the different uses to which they are put. In fire insurance there is an inherent connection between the building and its contents. It has been truly said: "The causes of fire are almost infinite in number, because every substance and almost every process of labor, manufacture, or commerce is, under certain circumstances or in certain relations to other articles or processes, productive of danger from fire." Manifestly, in the interests of justice as between one property owner and another, a distinction must be made by fire-insurance companies between all the various uses or "occupancies" of different buildings, although belonging to the same class. To be just in their premium charges it is also essential for the companies to change their rates to meet changing business conditions. Rate-making in fire insurance does not present constant factors, and justice demands that the companies should recognize the frequent changes which occur in the methods of manufacturing, commerce, heating, lighting, etc., as well as in statutory enactments and the management of property.

Considerations like these serve to show that fire rates are fundamentally different from rates in most other branches of insurance, and unless apportioned by *system* as contracted from *chance*, are bound to produce endless friction between

the underwriters and the public. In life insurance the problem of fixing rates has been reduced to a mathematical science. During the last thirty years the rate of mortality for the general population has scarcely varied. Applicants who do not qualify according to a certain arbitrary standard are as a rule rejected, while those who do qualify are generally insured without discrimination in rates. The difference in hazard between insurable risks in life insurance is relatively small, and the factors governing the law of mortality are almost constant. In fire insurance, however, as stated by Mr. F. C. Moore, "there are more than a hundred features of construction in a single building which should enter into the consideration of its rate, irrespective of nearly forty features of its city or environment, nearly forty more different features of fire appliances, to say nothing of more than a thousand possible hazards of occupancy." It is the duty of fire-insurance companies to take all these factors into account, to properly classify them, and then to assess a rate on every individual property which shall justly measure the risk. This is, to say the least, a gigantic task, and since no man's memory is capable of remembering all these items, and no individual knowledge is sufficient to put a price on them all, the fire-insurance business has recognized the necessity not only of conference, which makes possible the combining of the knowledge of many underwriters, but also of furnishing to the fire-rater a printed schedule which will serve as a guide to his memory and prevent mistakes and omissions.

*Systems of Rating.*—Generally speaking, fire-insurance rates are determined in two ways, viz., by personal judgment or by schedule. The first of these methods is being rapidly displaced by the "schedule system," although at one time, when the fire hazard was less complex than now, it was in general use, and served its purpose well. Its operation is well described by Mr. Richard M. Bissell in his lec-

ture on "Rates and Hazards."[1] He says: "By means of a more or less complete system of classification, companies ascertained in a rough way the average cost of many kinds of risks, and this information was put into the hands of their special agents or gradually absorbed by them in the course of their work. Formerly special agents did practically all of the work of making rates in company with local agents. When a town was to be rated, these average cost figures were used as basis or foundation rates. Usually towns were rated by committees of from two to five special agents who acted for all companies. No rule or regular method of procedure governed the making of rates under this system. The rates so made simply indicate the opinion or judgment of the rate-makers. Little attempt was made to analyze the factors which determined the judgment of the committee as to each risk. Nevertheless, since that judgment was usually the result of the experience and observation of many years spent in such work, the rates made were in many cases quite satisfactory, and equitable to a moderate degree. No attempt was made to take account of minor differences, but all good features or defects of construction and exposure, and also all the hazards of occupancy and processes, were lumped together, and if, as a whole, to the mind of the raters, they were sufficient to appreciably differentiate the particular risk from the average risk of its class, a penalty was added to or an allowance was made from the average rate which experience had shown to be about adequate."

Under such a system it is apparent that personal judgments might differ greatly, and that unlike rates might result in the case of similar risks. With the increasing complexity of modern construction of buildings, the introduction of numerous fire-protection facilities, and the devel-

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[1] Yale Insurance Lectures, vol. 2, pp. 106, 107.

opment of manufacturing and commercial processes, the shortcomings of this system became more and more apparent. Justice in rate-making required that all these changes should be properly considered, and in consequence less and less reliance was placed upon personal judgment in making rates, and instead the companies depended more and more upon the use of specialized schedules.

Originally two rates were applied, according to whether the building was of brick or frame construction, but such important features as occupancy received little or no consideration. In more recent years the companies have resorted to elaborate classifications of risks, until to-day properties are divided by some companies into more than a hundred main classes, each class in turn being subdivided according to construction, fire protection, and the type of city. Statistics and other data have been collected by the several companies with a view to ascertaining the average cost of insuring each of these groups. In fact, it is stated that over $1,000,000 is expended annually by the fire-insurance companies of this country for rating purposes.

A great variety of rating schedules are used in various states and cities of the country, but most of them, while differing in details, resemble each other in principle. In the case of various groups of properties, where but few differences exist in the class, such as residences, schools, etc., the rate for the class is applied, and allowance made for the type of construction and the presence or absence of efficient fire protection. On the other hand, in the case of "special hazards," such as manufacturing risks, mills, elevators, warehouses, etc., special schedules are prepared. These, generally speaking, describe a building which is "standard" as regards construction, arrangement of processes, and fire-extinguishing facilities. For such a standard risk a basis rate is then adopted, which, in the judgment of expert raters, measures the various factors pertaining to the hazard involved. To

this basis rate certain stipulated charges are next made for defects in construction, arrangement, and fire-protection facilities, as compared with the defined standard building. On the other hand, certain deductions are made for unusually good features as compared with the standard. Deductions or charges are made also for the presence or absence of coinsurance, faulty management, exposure hazards, and other features, and in nearly all cases the penalties in the form of additions for defects are made so heavy as to furnish a strong inducement to the manufacturer for the installation of improved methods of construction and operation. A large number of such special schedules exists, many of which are very intricate and detailed. In most instances expert service, usually given by men acting for a group of companies, is necessary for their application.

In the rating of mercantile properties fire-insurance companies use a large variety of schedules, varying from the simple in small towns to the elaborate in larger cities. According to the average schedule, cities and towns are divided into classes according to the degree of fire protection afforded. Next two basis rates are adopted in each town—one for brick and the other for frame construction—each measuring the hazard for an assumed type of building in each class. In the brick schedule additions are then made for defects of construction and exposure hazard, and deductions allowed for good features. To the rate as determined up to this point, called the "unoccupied building rate," an addition is made to measure the hazard of the occupancy connected with the building. The contents of the building, on the other hand, are often rated by making an addition to the building rate as outlined in the schedule, but more frequently the contents of such buildings are grouped into from three to five classes, and an addition made to the building rate for each of these classes.

In the case of frame buildings a basis rate is adopted in

each town and city, to which additions are made covering the occupancy and the exposure hazard. The rate on the contents of frame buildings, however, is seldom higher than the rate on the building, and in most cases is less, because the goods can often be easily removed in case of fire.

In recent years several attempts have been made to devise a schedule which can be universally applied throughout the country in rating mercantile risks. Of these attempts two deserve special mention, namely, the "Universal Mercantile Schedule," prepared by a large number of underwriters, acting under the chairmanship of Mr. F. C. Moore, and the other the "Mercantile Tariff and Exposure Formula for the Measurement of Fire Hazards," designed by Mr. A. F. Dean, of Chicago. While these two schedules present many vital differences, their object is to furnish a basis of rating mercantile risks which can be applied to all mercantile properties, no matter where located. The Universal Mercantile Schedule, or a modified form of it, is now used in many of our largest cities, such as New York, Philadelphia, Cleveland, and others, while the so-called Dean Schedule is used widely in a number of Western states.

# CHAPTER XVII

## FIRE-INSURANCE RATING (Continued)—SCHEDULE RATING

WITHOUT attempting to trace all the various rating schedules which have characterized the fire-insurance business in the past, or are now applied to certain special types of property, let us analyze the leading schedule of to-day, namely, the "Universal Mercantile Schedule." As its name suggests, this schedule was framed for the rating of mercantile property, by far the most important class, both as to value and the number of risks. It is the product of hundreds of eminent underwriters under the leadership of Mr. F. C. Moore, and represents their united underwriting experience. "It is," as Mr. Richard M. Bissell writes, "so far as results yet obtained are concerned, the most important of any of the tariffs which have been issued. It is also, of all rating schedules, the one which had been carefully and minutely elaborated and adjusted to meet the almost infinitely varied combinations of the factors of construction, occupancy, and protection which are to be found in the mercantile buildings of a large city. This schedule was a great advance beyond anything before known in the history of scientific rating, and has exercised a very important and growing influence upon the framers of other schedules subsequently made, many of which are but imperfect adaptations of the Universal Mercantile Schedule." [1]

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[1] Richard M. Bissell's lecture on "Rates and Hazards," Yale Insurance Lectures, pp. 115, 116.

*Standards in the Universal Mercantile Schedule.*—The starting point in the fixing of a rate on a non-fireproof brick building under the Universal Mercantile Schedule is the adoption of a standard—a standard building in a standard city—by which to judge other risks which may be poorer or better in quality. A standard city is one with gravity waterworks with sufficient power to throw water over five-story buildings, and with water pipes and mains not than six inches in diameter in the dwelling section and not less than eight inches in the mercantile section. It must have a paid fire department with twelve men to each steamer, and with at least two steam fire engines to each square mile of compact portion. Among other requirements, this city must also possess a fire-alarm telegraph, an efficient police, paved or other hard streets, the majority of which are seventy feet wide, a good building law, no outlying exposures such as lumber districts to cause sweeping fires, and a previous five-year record not exceeding $5 annual fire loss per $1,000 of insurance.

A standard building, as defined by the schedule, is one with brick or stone walls at least twelve inches thick at the top story and increasing four inches in thickness for each story below to the ground. Among other requirements, the building may not be over 2,500 square feet in area, or over four stories high, and the floors, windows, beams, girders, walls, and doors must be of approved construction, so as to resist the progress of a fire. For such a standard building, situated in a standard city, the schedule fixes a rate of 25 cents per $100 of insurance, and this rate—the "basis rate" —is the starting point in the computation of all rates. If the building or city under consideration does not measure up to the standard adopted, the actual rate charged is found by adding certain charges to this 25-cent basis rate for any defects, or by deducting certain charges from this rate for exceptionally good features. In framing the schedule the

committee which undertook the work aimed "to secure a rate on which the fire cost of the past five years per $100 of insurance would result in such percentage of the premium as, with an allowance for proper expenses, and, also, for accumulation for periodical and inevitable sweeping fires or conflagrations, would leave a margin for a moderate profit not exceeding five per cent."

The "basis rate" being fixed at 25 cents, the first step in the process of rate making is to determine the rate on a standard building in the given city. This is done by adding charges to the 25-cent rate for special hazards of the city in which the property is located. Thus, to illustrate, if the town has no fire department, an addition of 32 cents is made to the 25-cent rate. If there is no building law, the extra charge for this item is 3 cents; while if there is danger of sweeping fires from outlying exposures, such as extensive lumber districts, the charge is 5 cents. In all, some thirty-one deficiencies of the city are provided for in the schedule. Deductions from the original 25-cent rate are permitted, however, for certain exceptionally good features of the city. After all such additions and deductions have been made, the result is the basis rate for a standard building in the given city. This rate, the "key rate," as it is designated in the schedule, is then used as the starting point for rating all buildings in the city.

*Variations from the Standard.*—But most buildings will not measure up to the standard building, and further additions must, therefore, be made to the "key rate" for any deficiencies which may be found. If, for example, the walls have an average thickness of less than twelve inches, a charge of not less than 8 cents is added to the rate. If the roof is a shingled one, 15 cents is added, while for a slate roof the addition is only 2 cents. For wooden ceilings not less than 5 cents is added for one story and 3 cents for each additional story. Numerous other charges, all carefully

ing rate to obtain its stock rate." Hence the rate of the building occupied, minus one fourth of the deficiencies of the building, the amount determined upon by the framers of the schedule, is considered the "key rate" for all stocks in the building.

To this key rate there is next added the figure in the second column of the occupancy table. All stocks are arranged alphabetically in a table of two columns, the figures in the first column measuring those features of the stock which will cause fires, and the second column containing those figures which measure the susceptibility of the stock to damage by water, smoke, heat, etc. It is clear that many stocks are much more apt to be the cause of severe fires, and should, therefore, materially increase the rate of the building in which they are located. On the other hand, there are many stocks, such as hardware and the like, which, while not hazardous as a cause of fire, are nevertheless peculiarly subject to damage by water or smoke, although the fire may never reach large proportions.

Following this addition to the "key rate" for the susceptibility of the stock to damage from the resultant effects of fire, the method pursued in arriving at the final rate of the stock is very similar to that explained in connection with the rating of the building. As shown by the rating slip, deductions are next made for various fire appliances, giving us, as a result, the "*rate on the stock in the unexposed building.*" Additions must next be made for the presence of an exposure or conflagration hazard, and then follows a deduction for the presence of automatic sprinklers. Following this, deductions or additions are made for the presence or absence of coinsurance, giving the net "*rate on the stock with........per cent coinsurance.*" To this rate additions are next made for adverse legislation and faults of management, just as was done in rating the building, thus giving the "*final rate on the stock.*"

*The Advantages of Schedule Rating.*—Schedule rating serves to show that the equitable apportionment of the fire tax requires a systematic consideration of the hundred and one features which make one risk different from another. It is designed to make fire-insurance rates accurate and equitable, and to enable the property owner to see how his rate is made in every case, and thus allay the suspicion of unfair treatment which has been so prevalent in the past, and which has led to endless friction between insurer and insured. Much of the unwise state legislation is traceable to the failure of the public to understand the difficulties of just rating. "They reason," as Mr. Dean writes, "that when a number of competing corporations charge the same price for the same thing, it is a self-evident conspiracy in restraint of trade; in other words, a trust. The thing appears to be crooked when it is mathematically straight, and without the slightest effort to learn the truth, tariff and rating associations are declared unlawful under severe penalties."

But quite as important as the alleviation of the opposition of policy-holders and legislatures to insurance companies, is the necessity of reducing the fire waste of the country. Every one concedes that it is to the field of fire prevention that activity should be largely directed. Schedule rating is admirably adapted to accomplish much in this direction, if only the property owners and legislators would acquaint themselves with the substance and purpose of the leading schedules in use. In fact, this is one of the chief advantages attributed to the Universal Mercantile Schedule by its chief founder, Mr. F. C. Moore. He says: "It encourages proper construction of buildings by intelligently charging for deficiencies from standards, and by recognizing exceptionally good construction by deductions. The architect, builder, and property owner, informed at the outset as to what can be saved by proper construction, will be led to avoid many of the faults now prevailing, which have grown,

not unnaturally, out of the present system of conducting the insurance business.''

The advantage secured by such action on the part of property owners would not only in the long run affect the saving allowed by the schedule as it stands to-day, but would materially tend to lower the enormous fire waste of the country, and thus proportionately reduce the rates of to-day. If the owners of establishments can be made to see that by making improvements here and there in the construction and management of their property they will receive a reduction in their premiums, amounting to more than a good investment return on the capital expended, it is only reasonable to assume that such improvements will be made. If state legislatures and city councils can be made to see, as many have, that by improving a fire department, by passing proper building laws, and by introducing an efficient system of water mains, they may materially reduce the rate on all property in the city, it is reasonable to assume that they will act in the interests of the community. Any progress toward the reduction of the fire waste will not only lower rates, but will lessen that large loss, so often overlooked, resulting from the inconvenience, loss of time, and the demoralization of business, which follows in the wake of every large fire.

To these benefits it should be added that schedule rating gives the further advantages of making inspections more thorough and discouraging the payment of excessive commissions for the writing of ''preferred'' risks. It is apparent that schedule rating will serve as a check upon the judgment and memory of the inspector, and will prevent important departures from the prescribed standards. On the other hand, a rating schedule reduces all risks, for rating purposes, to a common level, making them all equally desirable. The company is enabled to make as much profit in underwriting a poor risk at a high premium, as by insuring

a good risk at a lower rate, thus removing the necessity of granting higher commissions for the procurement of preferred classes of risks. By making possible a full explanation of why a certain rate is charged, property owners can also be made to see the folly of accepting policies in companies which charge unscientific and inadequate premiums, thus in the long run preventing hurtful competition and cutting of rates.

*The Dean Schedule.*—The "Mercantile Tariff and Exposure Formula for the Measurement of Fire Hazards," or the "Dean Schedule," as it is commonly called, differs from the Universal Mercantile Schedule in many important particulars. While affording the advantages of schedule rating, it is based upon principles radically different from those used in making the Universal Mercantile Schedule. Owing to its general use in many of the Western states, it will be our object to point out briefly the essential differences between the two schedules, as illustrated by that portion of the Dean Schedule devoted to the rating of brick buildings.

1. In the first place, Mr. Dean's schedule does not attempt to prescribe a basis rate for a standard building in a standard city, but instead, cities and towns are divided into six classes, varying all the way from those without any fire protection to those with excellent facilities along this line. Then, instead of adopting a "standard building" of ideal construction, Mr. Dean uses as a starting point in his rating system a one-story brick building of "ordinary construction, situated in a town of the lowest or sixth class." In adopting an ideal standard building for rating purposes the Universal Mercantile Schedule seeks to produce an educational effect; but Mr. Dean, on the contrary, makes no attempt along this line, but begins with the average building. Underwriters, it is argued, are familiar with this ordinary type of building, and are relieved of the necessity of making the large number of additions for de-

fects required by the Universal Mercantile Schedule, which, as we have seen, assumes as a starting point a standard building much superior in character to the average building.

Unlike the Universal Mercantile Schedule the Dean Schedule also allows latitude in naming the basis rate, the raters in each locality being allowed to select that basis rate which is best applicable to the community in question, since, it is argued, the underwriters are best able to judge the basis rate that should be applied to their particular districts. To enable underwriters in the various localities to select a proper basis rate, Mr. Dean furnishes a number of tables indicated by the titles "60 cents," "65 cents," "70 cents," "75 cents," etc., up to 120 cents, these figures representing the basis rate for a one-story building in a town of the sixth class. He leaves it to the raters of the various districts to choose the table which they think best suited to the local conditions; but having selected one of the tables (i.e., having chosen a basis rate), it is recommended that the same be strictly adhered to in other particulars. As an illustration the 60-cent basis rate table is given:

60 CENTS.

| Height. | Class 1. | Class 2. | Class 3. | Class 4. | Class 4½. | Class 5. | Class 6. |
|---|---|---|---|---|---|---|---|
| 1 story | .33 | .37 | .42 | .47 | .52 | .57 | .60 |
| 2 story | .34 | .39 | .44 | .49 | .54 | .59 | .63 |
| 3 story | .36 | .40 | .46 | .52 | .57 | .62 | .66 |
| 4 story | .38 | .43 | .49 | .55 | .61 | .66 | .70 |
| 5 story | .41 | .47 | .53 | | | | |
| 6 story | .46 | | | | | | |
| Increase for each additional story | .07 | .07 | .07 | .07 | .07 | .07 | .07 |
| Decrease if no basement | .02 | .02 | .02 | .02 | .03 | .03 | .03 |

In case the underwriter wishes to rate a three-story brick building in a city of the second class, and has decided

to adopt the 60-cent rate table, it is only necessary in arriving at the basis rate for the building to glance at the column entitled "Class 2," and opposite the line entitled "3 story," where there will be found the figure 40 cents, which represents the basis rate for the risk under consideration. On the other hand, if, owing to local conditions, the rater decides to select the 120-cent table, he will consult that table, pursuing the same method used in the previous case, and will find the figure 81 cents as the basis rate to be adopted.

2. Having determined the basis rate, the rater must next make certain additions and deductions which measure the deficiencies or good qualities of the building in question. In making such additions, however, Mr. Dean uses percentages in all cases, while the Universal Mercantile Schedule, as we saw, provides for the addition of absolute amounts, such as 5 cents, 10 cents, etc. This is done so as to maintain relativity in charges and credits, because, as Mr. Dean explains, certain features, such, for example, as an open elevator shaft, are much more dangerous in a tall building of large size than in a low one of moderate area. If the addition for a defective elevator shaft is measured by an absolute amount, say, twelve cents, in the case of all buildings, it is argued that this charge will be twice as large relatively for a building whose basis rate is 50 cents, as for one whose basis rate is $1. As a matter of fact, the situation should be reversed, and this, it is claimed, can only be done by making the addition in percentages, in which case the charge for the defect will be greater in the building rated at $1 than in the building rated at 50 cents.

3. Having entered on the rating slip the basis rate, and all charges and credits connected with the building, the next step in Mr. Dean's schedule is to refer to the classified list of occupancies, and enter the charges for occupancy found in columns 1 and 2. This table of occupancies differs very materially in form from the occupancy table found in the

Universal Mercantile Schedule. The table consists of three columns, a typical illustration of which is herewith given:

| | Occupancy. | Cause. | Media. | Effect. |
|---|---|---|---|---|
| 100a | ACADEMIES in Mercantile Buildings.. | 10% | | D2 |
| b | Technical Schools with apparatus... | 10% | | D3 |
| c | Manual Training with woodwork... | 20% | | D3 |
| 101 | ADVERTISING Novelties, etc......... | 10% | 20% | D3 |

A few words of explanation are necessary to show the application of this table as compared with the Universal Mercantile Schedule. As will be observed, Mr. Dean has divided his occupancy table into three columns, under the headings of (1) Cause, (2) Media, and (3) Effect. In the first of these columns is found the percentage to be added to the building rate for the particular occupancy because of its tendency to cause a fire; in the second column is found the charge which represents the combustibility of the stock, that is to say, the extent to which goods will contribute to the spread of a fire; and the third column indicates the grade of the article (the grades being represented by D1, D2, D3, D4, and D5) with reference to its "damageability," that is to say, the extent to which the goods are likely to be injured by the effects of fire, such as smoke, water, heat, breakage, etc. This classification of occupancies, it will be observed, is very elaborate. As regards "cause," it is apparent that some occupancies are much more dangerous than others, some, according to the schedule, being "inert," like banks, offices, studios, etc., while others are "active." Again, as regards the classification of "media," some occupancies involve merchandise of low combustibility, such as hardware, rubber goods, wool, and woolen goods; other occupancies involve merchandise which burns moderately, such as retail groceries, dry goods, and the like; other merchan-

dise burns freely, such as straw goods, hay, millinery, etc.; other goods burn with great intensity, such as matches, salt-peter, celluloid goods, etc., but are not subject to spontaneous combustion or destruction, except through actual contact with fire; while other grades of goods are of an extremely inflammable character, because they are liable to spontaneous combustion or burn with an intensity amounting practically to an explosion.

Mr. Dean has also elaborately classified the "effect" or damageability of various classes of merchandise. Merchandise, represented by the insignia "D1" in the table of occupancies, includes articles, such as leather goods, etc., which are largely immune from damage from the indirect effects of fire, such as water, smoke, and heat; "D2" represents articles, such as retail groceries, dry goods, etc., which are but moderately affected; "D3" relates to merchandise, such as paper, butter, fruit, books, etc., which are easily damaged; "D4" refers to merchandise, such as millinery, florists' stocks, contents of cold-storage warehouses, etc., which are liable to heavy damage from slight effects resulting from fire; while "D5" consists of mixed stocks of goods, such as those contained in department stores and general storage warehouses, which require a personal estimate to ascertain the average damageability.

Having added to the building rate the charges for occupancy found in columns 1 and 2 of the occupancy table, the difference between the total of the debit and credit columns in the rating sheet shows the percentage of the basis rate, which is to be added to it in order to obtain the "occupied rate of the building." From the rate as obtained up to this point there are next deducted certain credits for protective features.

4. In order to get the rate on the contents within the building, reference must be made to the "contents tables" of the schedule, with a view to adding to the occupied

building rate the amount indicated by the insignia D1, D2, D3, etc., as the case may be, according to the grade of protection for the town and the location of the contents in the building. Mr. Dean's contents tables are very ingeniously devised, the tables being so arranged that they take into account (1) the basis rate used in rating the building; (2) the class of city according to the type of fire protection; (3) the location of the contents, whether in the basement, or on the ground floor, second floor, etc.; and (4) the nature of the contents to be rated, whether belonging to class D1, D2, etc. Numerous tables are devised embodying the foregoing features, so that the rater need only look up the proper table with a view to finding the amount to be added to the occupied building rate, in order to determine the rate on the contents.

5. One of the most important features of Mr. Dean's schedule is the so-called "exposure formula." This has received much attention from underwriters, and has been commended very highly.[1] His treatment of the exposure hazard is very detailed, and merely the general outline can here be presented. External exposures are classified under three heads, namely: "(a) Radiated Exposure, consisting of the proportion of its own hazard a risk radiates toward exposed risks; (b) Absorbed Exposure, consisting of the proportion of the radiating hazard absorbed by an exposed risk; and (c) Transmitted Exposure, or the proportion of the hazard a risk absorbs from one side, and which is transmitted by it to a risk on the other side."

In connection with the above classification Mr. Dean points out: "(1) That every exposing risk radiates some ratio of its own hazard toward exposed risks; (2) that every

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[1] See Richard M. Bissell's remarks concerning Mr. Dean's exposure formula in his lecture on "Rates and Hazards," published in the Yale Insurance Lectures, Vol. II.

exposed risk absorbs some ratio of this radiated exposure; (3) that every risk transmits some ratio of the hazard it absorbs; and (4) that radiated, absorbed, and transmitted exposure is modified by structure, clear space, and fire-department protection." Mr. Dean next submits elaborate tables of alternative standards, with recommendations as to their application in the case of different classes of property, with reference to the clear space between the exposing and exposed buildings, and the grade of municipal fire protection.

# CHAPTER XVIII

## REINSURANCE

THE modern stability of fire-insurance companies and their ability to cope with even large conflagrations is largely due to their policy of limiting their "lines" of insurance. As was explained when we considered the organization of companies, the officers are equipped with special maps of towns and cities, which show the character of the fire department and water supply, the width of the streets, the class, construction, and occupancy of buildings, and the nature of the exposure hazard. These maps also show the "lines" of insurance in force on a building, or in an entire block or conflagration district. To make the application of the law of average reasonably certain, it is the policy of companies first of all to place a limit or so-called "line" upon the amount of insurance that they will carry on a building. Next a "block limit" is fixed, which represents the amount of insurance a company will carry on all the buildings within the block; and, finally, to afford protection against large conflagrations, companies will fix a "conflagration limit," which represents the amount of insurance the company is willing to carry on all the property situated within the area considered subject to sweeping fires.

In this connection it should be stated that companies very frequently have offers to accept much larger amounts of insurance on a given building or within a given area than they care to assume. Such "surplus lines" are distributed among other companies, i.e., are "reinsured." It is a com-

mon practice for groups of companies, where there is a mutual feeling of reliability, to assist each other in the distribution of risks. Thus one company may write a policy for $100,000 on a given property, although it may desire to retain only $10,000. In that case the company will place the remaining $90,000 with other companies, and these reinsuring companies, in turn, may again divide their risk by having a portion reinsured in other companies. By thus carefully restricting their "lines," and having all surplus lines reinsured, the liability of the companies is so well distributed that even large conflagrations like those in Baltimore and San Francisco will result in but few failures, and in most instances will not even lead to a reduction of the dividends to stockholders.

*Conditions Required in Effecting Reinsurance.*—Line 100 of the standard fire policy provides that "liability for reinsurance shall be as specifically agreed hereon." While this provision leaves the arrangement of conditions governing the reinsurance contract to the companies interested, certain precautions are almost invariably taken. In the first place, reinsurance should be effected for a company only when its line is too large for it to carry, and not when its desire to reinsure is prompted by a knowledge that the rate is too low or that the risk is too hazardous or otherwise undesirable. Reinsurance should especially be avoided where a moral hazard is found to be involved. Precaution should be taken to prevent the reinsuring company from separating the risk, retaining the best portion, and, through reinsurance, relieving itself of the most hazardous portion at the rate charged for the combined risk. It is also essential that the reinsuring company should not insure a policy for more than is retained by the reinsured company, even though the excess can be placed with other companies. To do otherwise may simply mean that the reinsuring company is guaranteeing the policy of a weaker company. The reinsurance

of a portion of the excess amount assumed with other companies will not necessarily protect the reinsuring company. In law it is held liable for the full amount assumed, and runs the chance of not being able to collect the portion which it in turn reinsured in another company. Thus, supposing that Company A writes a policy of $30,000 on a building, and, not wishing to carry so large a risk, induces Company B, a very reliable company, to reinsure it for $25,000. Company B, however, desiring to limit its loss, reinsures one half of its risk ($12,500) with Company C. Now let us suppose that owing to a conflagration, involving the loss of the insured building, Company C becomes insolvent. In that case Company B is legally liable to Company A for the entire $25,000 it assumed, and takes its chances of collecting only a portion of the $12,500 which it reinsured with Company C.

The importance of the foregoing considerations is generally recognized, and reinsurance agreements almost invariably contain conditions which seek to protect the reinsuring company from such contingencies. While the wording of the agreements for reinsurance is not always alike, the following two agreements are representative of those in general use:

(1)

REINSURANCE CLAUSE

**This Policy No. ......... reinsures the ...................... Insurance Company of ......................... in the sum of $....... of its liability as insurers under its Policy No. ........, issued in the sum of $........, in the name of ..................., covering the property described in the form attached to this policy. This reinsuring policy is subject to the same risks, conditions, indorsements, assignments, valuations, and modes of settlement as are or may be assumed or adopted by the reinsured company.**

**Loss, if any, to be paid pro rata with the reinsured, and at the same time, and upon the same terms and conditions.**

**It is understood and agreed that the company reinsured retains**

at its own risk at least an equal amount on the identical property reinsured by this policy.

Other reinsurance permitted without notice until required.

Attached to and forming a part of Policy No. ........ of the .................... Insurance Company of ..............., issued at its ................ Agency.

Dated ............ 191... ...................., Agent.

(2)

THE ...................... INSURANCE COMPANY

In consideration of the premium to be paid as set forth hereon does hereby reinsure the

..................................................................

on such property, for such amounts and for such period as shall be referred to and specified upon the reverse of this card.

It is a condition of this reinsurance that the reinsured company is to retain at its own risk, on the property on which this reinsurance applies, an amount equal to the amount of this policy, or failing to do so, this company shall not be liable for an amount greater than that for which the reinsured company may be liable for its sole account.

It is further understood and agreed that such reinsurance is a pro rata part of each and every item insured by the policy of the reinsured company and is subjected to the same risks, valuations, conditions, and mode of settlement as may be taken or assumed by said company; it being expressly agreed, however, that notice of any change in the risk or additional privileges granted shall be at once given to this company. Loss, if any, payable at the same time and in the same manner and pro rata with amount paid by said company. Other reinsurance permitted subject to the aforesaid conditions.

In Witness Whereof, the said .................. Insurance Company of .......................... has caused these presents to be executed and attested, in ................, upon the ........ day of ......... But the same shall not be valid until countersigned by its .............

Secretary.

In other instances the form of reinsurance agreement contains the stipulation that "it is a condition of this reinsur-

ance that if the reinsured policy is canceled or reduced in amount, this policy shall be canceled or reduced in like proportion, and that the reinsured company is to retain at its own risk (exclusive of any and all reinsurance) under the policy hereby reinsured an amount equal to the proportion which the amount of this policy bears to the amount of the particular policy hereby reinsured at the date this reinsurance is effected."

*The Application of the Reinsurance Contract to the Original Insured.*—By the weight of authority the original insured is regarded as a stranger to the contract of reinsurance, unless it is specifically agreed that he shall have an interest therein. In other words, when one company reinsures the risk of another, the contract is considered as having been made only between these two companies, and the reinsuring company is liable only to the reinsured company, and not to the policy-holder. Thus if property owner A insures his property for $10,000 with Company B, and B reinsures $5,000 of this risk with Company C, Company C will be liable only to B and not to the policy-holder A. In case B should be insolvent, it follows that A, in case of total loss, cannot collect the $5,000 directly from C. This sum will be paid to B, and when merged with the assets of this company for the general benefit of creditors, will somewhat enlarge the dividend paid to A as a creditor, but will nevertheless result in a loss. The case, however, is different where the policy-holder has been promised in the reinsurance contract that losses will be paid to him. Under such an agreement the policy-holder is entitled to collect his indemnity directly from the reinsurer.[1]

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[1]A few recent cases hold the contrary view, and regard the reinsurance contract written for the benefit of the policy-holder. See Hunt *vs.* New Hampshire, etc., Assn. (68 N. H., 305), and Shoaf *vs.* Palatine Ins. Co. (127 N. C., 308).

# CHAPTER XIX

## THE ASSIGNMENT OF FIRE POLICIES

In a former chapter reference was made to a section in the standard fire policy which relieves the company of all liability, unless it has given its consent, in case the insured property is sold, or there has been a change in title, interest, or possession. The fire policy, we saw, is essentially a personal contract, and this provision is, therefore, necessary and reasonable as a precautionary measure against fraud. For the same reason the standard policy contains another provision which prevents the assignment of the policy without the company's consent to a vendee of the property or to a creditor, or other interested party. The provision reads: "That this entire policy shall be null and void if without the consent of the company there be an assignment of the policy before a loss takes place."

It is a common practice for companies to consent to the continued validity of the policy as far as the purchaser of the insured property is concerned, where they are satisfied with his character. But the frequent extension of such acts of grace to the insured should not be interpreted as creating a general usage which compels the company to accept the purchaser as the insured. In life insurance the courts of many states have decided that, in the absence of restrictive provisions, the policy is assignable. But in fire insurance, on the contrary, it is a well-established legal principle that the policy, since it is a personal contract, can be assigned only with the consent of the company. In case of the transfer of the insured property, the company may refuse its con-

sent to the transfer of the policy, and will be relieved of all further liability. The policy form usually provides two assignment blanks on the reverse side, which must be properly filled by the insured and insurer to effect an assignment.

ASSIGNMENT OF INTEREST BY INSURED

The interest of ........................ as owner of property covered by this policy is hereby assigned to ...................... subject to the consent of the ........................ Company.

.............................

Date................ (Signature of the insured.)

CONSENT BY COMPANY TO ASSIGNMENT OF INTEREST

The ........................... Company hereby consents that the interest of ........................ as owner of the property covered by this policy be assigned to ..........................

.............................

Date................ (Signature for company.)

*Assignment of the Policy when There Has Been a Transfer of the Property.*—In discussing the legal nature of an assignment of a fire policy, it is essential to distinguish between those cases where there has been an actual transfer of the property and those where there has not. Thus where a policy is assigned to a mortgagee as his interest may appear, we have already seen that the mortgagee is not absolutely protected, because in law the mortgagor is still regarded as the owner of the property and the holder of the policy, and it is, therefore, his conduct which will control the validity of the policy. The policy may be valid at the time of assignment to the mortgagee, but may be rendered null and void thereafter by the mortgagor's improper conduct. Or, the mortgagor may already have violated the policy so as to make it void at the time of the assignment, in

which case he cannot convey to the mortgagee more than he himself possesses, and the mortgagee, as assignee, cannot receive more than the mortgagor was in a position to give. To overcome this obstacle, it has already been explained that it is the general practice of companies to protect the mortgagee by indorsing on the policy a special mortgagee clause which promises to indemnify him as his interest appears, and especially provides that he shall be protected against any act on the part of the mortgagor which may invalidate the insurance.[1]

Where, however, there has been an actual transfer of the title, and the policy has been assigned with the company's consent, it is the general rule to view the assignment as constituting a new and independent contract between the assignee and the company. The assignee will thus be protected against the acts of the original policy-holder, and this is true even though the company lacked knowledge of some improper conduct of the assignor with reference to the policy conditions. With the transfer of the policy by assignment, consented to by the company, the purchaser is considered by the courts to be protected in the same way as if the company had reissued to him a new policy, similar in all respects to the policy held by the person originally insured. Mr. Ostrander, in summarizing the various legal decisions which define the character of an assignment where there is a transfer of the property, gives the following explanation: "The assignment in such case has no other legal effect than to acquit the company as to the party first insured. This might be done in a different, and perhaps better, form, but the method chosen is sufficient to accomplish the object sought. It is a short, simple process to release the insurer as to one party, and bind it as to the other. In Continental Insurance Co. *vs.* Munns (120 Ind., 30; 22 N.E., 781) the

[1] See Chapter on the "Mortgage Clause.'

property had been mortgaged in violation of the conditions of the policy, which was subsequently assigned, on sale of the property, with the consent of the company, who had no knowledge of the forfeiture occasioned by this circumstance. The court said 'that the policy expires with the transfer of the estate, so far as it relates to the original holder; but the assignment and consent of the company constitute an independent contract with the assignee, the same in effect as if the policy had been reissued upon terms and conditions therein expressed. . . . The contract of insurance thus consummated arises directly between the purchaser and the insurance company, to all intents and purposes the same as if a new policy had been issued, embracing the terms of the old. In such a case no defense predicated on the supposed violations of conditions of the policy by the assignor will be available against the assignee.' "[1]

*Where the Policy is Assigned as Collateral Security for Loans.*—Unless provided in the policy to the contrary it is the general rule that an assignment of the policy for collateral security will not invalidate the policy, even though this may have been done without the company's knowledge. The assignor continues to be the owner of the property and is still the insured, although the assignee has a lien on the insurance which will protect him in preference to other creditors.

Mention should here be made of the practice which many companies pursue of enabling a policy-holder to protect his creditors quickly with insurance. In many lines of business, for example, large quantities of produce, such as grain and cotton, are bought on borrowed funds, which must have as security not only the goods purchased, but also the promise of indemnity in case of loss through fire or marine disasters. Thus in the grain, cotton, and other produce

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[1] Ostrander on "Fire Insurance," pp. 502, 503.

markets it is customary to buy a quantity of the produce, immediately have it represented by warehouse receipts or bills of lading, and then to offer these, together with a fire policy in a responsible company, to a banker for a loan of about 90 per cent of the market value of the goods, and with the proceeds of the loan to effect a new purchase, again insure the same, and by offering the new warehouse receipts and the new fire policy as collateral security, effect a new loan. By repeating this operation, as we saw in the chapter on "The Functions of Fire Insurance," it becomes possible to transact a business from five to ten times the size that would be possible if all purchases were made on a cash basis. This method of buying on credit exists in all the leading produce markets, and in many instances the property purchased one day may be sold the next. The issuing of a new policy each time a purchase is made, or the assignment of the interest in the policy each time all, or a part, of the property is sold would certainly cause delay and inconvenience for all parties involved, and would prove a severe handicap to the smooth working of modern industrial machinery.

In view of these circumstances many companies make it possible for the insured to purchase a certain amount of insurance, and then to protect creditors by issuing against this insurance certificates properly countersigned by the designated representative of the company. One large marine-insurance company, for example, extends a privilege of this kind extensively to cotton dealers. Having secured a certain amount of insurance, a dealer, upon the purchase of cotton on borrowed funds, can immediately furnish his bank with the requisite amount of insurance, and the company will later acknowledge its liability by letter. The most general practice, however, is for the insured to issue a "certificate" properly countersigned, which certifies that he is the holder of a certain amount of insurance under a cer-

tain policy, terminating at a certain date, and that any loss will be adjusted in conformity with the conditions of the policy, and made payable to the party designated therein as payee upon the snrrender of the certificate. The following is one of the forms of such certificates:

No. ........

..............................

............, 19 .

This certifies that ............................. ha.. insurance by this company, under Policy No. ........., Entry No. ......... to the amount of ...... .................... dollars, on ........ ................................................................,
terminating .......... day of ........, 19.., at noon.

Loss, if any, in conformity with the conditions of said policy, to be adjusted with ........................... and payable to .......................... only on presentation of and surrender of this certificate.

Countersigned at Philadelphia, this ....... day of ......, 19...

......................., Manager

# CHAPTER XX

## FIRE PREVENTION

FIRE prevention in the United States presents problems of a totally different character from those met with in other countries. In Europe buildings are comparatively low, of limited area, and frequently with wide spaces between them. They are, as a rule, of solid masonry construction, and provided with small window openings. In the United States, on the contrary, business exigencies have not been conducive to the adoption of such precautionary measures. American cities have been built rapidly and as cheaply as possible. Wood, because of its cheapness and abundance, has been used extensively in the construction of floors, roofs, and walls. The congestion of business sections in our large cities has become alarming, and has not been marked by any proportionate effort to prevent conflagrations. Everywhere the tendency has been to regard the needs of the present as much more important than those of the future. Mr. Everitt U. Crosby, at that time Chairman of the Executive Committee of the National Fire Protective Association, wrote, in 1904: "Speaking generally of city districts, intelligent treatment of the individual risk as regards construction and fire extinguishment has been given only in occasional, yet important, instances, and the conflagration hazard has not been provided against. Where municipal building regulations exist, they have been poorly drawn in respect to fire prevention, and sometimes poorly observed. It is apparent the desire for better things must be stronger in

the heart of those most interested before any radical reform can take place."

With such a state of affairs existing in America, it is only natural that there should result an enormous fire waste, aggregating annually over $200,000,000. In our largest cities property owners are complaining loudly of the heavy insurance tax, and fire-insurance companies are confronted with much opposition from policy-holders and legislatures. The total tax is excessive, but any effort to make the same smaller must be directed toward the reduction of the excessive fire waste in the country. In European countries like France and Great Britain, the average loss per hundred dollars of insurance is only one ninth to one sixth as large as here. Fire underwriters are agreed that it is in the field of "fire prevention" that a solution of present difficulties must be found, and for years the engineers of the insurance companies have studied American conditions in detail, and have devised fire-extinguishing facilities which, if generally adopted, would bring about a decided improvement.

Fire prevention has assumed such importance that there has developed a special science which goes under the name of "fire-insurance engineering," and which to-day enlists the services of many capable men, who make it their exclusive business to apply the principles of engineering to the prevention of fire. These men visit all manufacturing and mercantile risks which are insured, and, with the aid of question blanks, carefully examine the construction of the plant, the hazard connected with the occupancy and the materials used, the exposure from surrounding risks, the fire-protection facilities, and all other circumstances attaching to the risk.

Many of these inspectors are employed by insurance companies, large industrial corporations, or large insurance brokerage firms. To lessen the expense, however, it is desirable to have as much cooperation as possible in obtain-

ing information, and to this end, so-called "inspection bureaus" have been organized. These have as members a large number of companies, all of which receive the information collected. Such inspection bureaus are usually so organized that a trained inspector can be provided for each district, and an immediate inspection made, when desired. The benefits to the companies consist in lessening the amount of loss through the proper arrangement and betterment of risks, and in guarding against the assumption of dangerous hazards. The owner of the property, however, is also benefited, since he is advised how he may change his plant so as to lessen the danger of fire.

Much valuable assistance is also rendered by the National Fire Protection Association, which was organized for a threefold purpose: "To promote the science and improve the methods of fire protection and prevention; to obtain and circulate information on these subjects; and to secure the cooperation of its members in establishing proper safeguards against loss of life and property by fire." Through special committees this association renders an invaluable service in formulating rules and standards for the guidance of inspectors as well as property owners, regarding the construction and use of various fire-preventive appliances and materials. Laboratories are also maintained by the companies, where, with the advice of the several committees of the National Fire Protection Association, tests are made to verify the merits claimed by the inventors or selling agencies of fire prevention or fire-protection devices, such as fire extinguishers, fire doors, shutters, sprinklers, electrical materials, lighting and heating devices, building materials, etc. In this way the good is separated from the bad, and property owners can be informed as to the standards that ought to be used.

Mention should also be made of the work done along lines of fire prevention by some of the larger companies, and

especially by the factory mutuals. The latter, we have seen, emphasize fire prevention above everything else, and the remarkably low premium rates or large dividends of these companies, as the case may be, are the result of the rigid enforcement of stringent rules relating to fire prevention. It has also been the practice for fire-insurance engineers, usually acting in cooperation, to visit the large cities of the country, and carefully inspect and report on the water supply, the fire department, the conflagration hazard, and all other important local conditions.

"Fire prevention" involves two lines of effort, namely: the prevention of the origin of fires, and the prevention of the spread of fires when once under way. It thus becomes necessary to study, first, the use of fire-extinguishing and fire-notification facilities, and second, the planning, construction, and occupancy of buildings with a view to reducing the fire loss to the minimum.

### FIRE-EXTINGUISHING FACILITIES

*Standpipes and Water Pails.*—Every building should be supplied with fire-extinguishing facilities in proportion to its area and height. Standpipes should exist, with siamese or double connections, for the use of fire engines in the street; and at the windows there should be hose outlets, so as to make unnecessary the carrying of hose upstairs. In high buildings internal standpipes should exist, supplied from roof tanks supported on iron beams. According to the Universal Mercantile Schedule, the presence of an internal standpipe with tank supply will mean a reduction of 2 per cent in the occupied building rate, while the presence of an external standpipe with siamese connection for the use of the fire department will mean another reduction of 1 per cent.

Of fundamental importance in mercantile risks is the presence of a proper supply of fire pails filled with water.

"The best fire appliances, strange as it may seem," writes Mr. F. C. Moore, "are the cheapest pails filled with water ready at every staircase, and for the reason that every one knows how to use a pail of water, while the average person, especially in the hour of excitement and danger, does not understand patent fire-extinguishing appliances, and might not know how to turn on the valve of the standpipe and bring the hose into action. Even in manufactories, where cool-headed mechanics might be supposed competent to handle fire apparatus, more than 65 per cent of all the fires are extinguished by pails of water."

How highly underwriters regard these simple but effective appliances may be judged from the reduction in the fire rate, which their presence secures. If six filled pails of water exist for every 2,500 square feet of floor area, a 5 per cent reduction in the occupied building rate is allowed. Since fire pails cost about $4 per dozen, the saving in the rate constitutes a very material return on the capital invested. Thus, in the case of a manufacturing risk which the writer has in mind, the value aggregated $300,000, the area 50,000 square feet, the rate 1 per cent, and the total premium for full insurance $3,000. To secure the reduction of 5 per cent in the occupied building rate, or $150, requires the provision of six fire pails per 2,500 square feet, or 120 pails for the 50,000 square feet of area in the building, at a cost of about $40. In addition to this saving, amounting to several times the capital invested in the fire-extinguishing appliance, there is also the added protection against the important risk of loss in time and business, which would result from a fire on the premises.

*Fire-Notification Facilities.*—Among the remaining types of fire-extinguishing apparatus may be mentioned public and private water-works systems, post hydrants, a public and private fire department, three-gallon carbonic-acid chemical extinguishers of approved type, playpipes, span-

ners, stationary steam fire pumps, and pressure and gravity tanks. But in order to make these various types of fire-extinguishing apparatus as quickly available as possible in cases of fire, certain notification facilities must also be installed. Consequently, there are frequently used automatic fire-alarm systems, which extend to all portions of the building. In connection with the sprinkler service, to be described later, an electrical notification system is also coming into use, which will give immediate notice to a central station in case there is too high or too low a temperature or water level in a gravity or pressure tank, or in case the water in the pipes of the system is set in motion.

The importance of such appliances to the property owner, who is always viewing his business from the profit standpoint, and who is, therefore, reluctant to introduce the same unless he can see a personal profit, regardless of the demands which the community may justly make upon him in the interests of the common safety of all against the conflagration hazard, may be seen by observing the Universal Mercantile Schedule. If there is one hydrant, supplied by an eight-inch water main, within 300 feet of the building, a reduction of 5 per cent in the occupied building rate is allowed; and if two or more hydrants, supplied with eight-inch water mains, exist within 300 feet, the reduction is raised to 10 per cent. The installation of an automatic fire-alarm signal to a central fire station or fire department enables a property owner to secure another reduction of 5 per cent in the occupied building rate, while the presence of an auxiliary private fire plant and force pump means a reduction of another 10 per cent. In addition to these appliances, it is still customary to employ the old-fashioned watchman, but no longer under the happy-go-lucky methods of former years. To make the watchman honest and efficient, he is in turn watched by a central station, or by a stationary or portable clock system. If there is a watchman

on the premises, the Universal Schedule grants a reduction in the occupied building rate of 5 per cent; if, however, there is a watchman with watch clock or electric director, the reduction is increased to 10 per cent.

*Automatic Sprinklers.*—But the best by far among the automatic devices for extinguishing fires in their incipiency is the automatic sprinkler. It must be apparent that the checking of a fire in its earliest stage is of transcendent importance. In fact, it is a maxim among fire underwriters that practically every fire can be prevented with a cup of water, if available in time. A few minutes' start in a building with unprotected vertical openings through the floors, and filled with large quantities of highly combustible materials, may suffice to spread the flames from top to bottom of the structure. Within a few minutes so much material may be set on fire as to thwart the efforts of any fire department to cool off the mass faster than the fire spreads to new stocks of combustible goods.

Considerations like these show the supreme importance of having some automatic device which, without the assistance of human effort, will discharge water almost simultaneously with the outbreak of the fire, will apply the water locally in the very spot where combustion is taking place, will distribute the discharge of water in such a manner as to accomplish the greatest good with the least amount of water, and will also give immediate notice of the existence of a fire. Such a device, it may seem at first thought, is quite impossible of realization. Yet years of experimenting have resulted in the modern sprinkler system, which operates automatically, applies water almost simultaneously with the outbreak and in the precise location of the fire, and which, through the sprinkler pipe-alarm valve, gives immediate notice at any desired point.

The automatic sprinkler may be described as an arrangement of pipes regularly spaced under all ceilings for dis-

tributing water, supplied automatically from elevated tanks, pressure tanks, pumps, or city connections, to all portions of a building, and having valves so arranged as to open when any undue rise of temperature occurs. In other words, for about every 75 to 80 square feet of floor area, there exists a sprinkler, arranged with valves and fed by water through a system of main and distributing pipes. The arrangement of the valves, so as to open with a rise of temperature, is

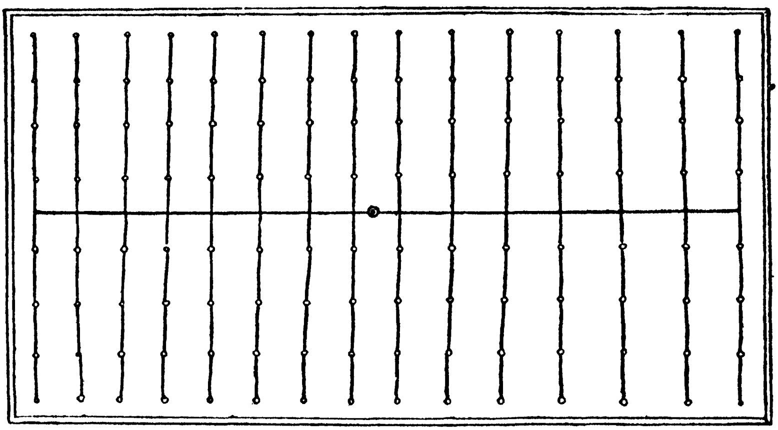

FIG. 9.—Center Central Feed to Automatic Sprinklers.

O shows a sprinkler. ⊙ shows a riser.

brought about by having the joints soldered with fusible metal, which will melt with increasing temperature, and release them as soon as heated. The fusible solder used is, for the sake of convenience, adjusted for different temperatures, varying from 165 to 360 degrees, according to the nature of the risk to be protected.

As explained by Mr. Frederick C. Moore, "A single sprinkler at 30 pounds pressure per square inch will discharge as a fine spray about thirty gallons a minute. Under most conditions the operation of one or two sprinklers would have 30 pounds pressure. At 100 pounds the impression is

created in the mind of an observer that the spray is so dense and forcible that a man directly under the sprinkler would be strangled." The sprinkler may be used in all classes of risks, such as factories, hotels, elevators, mills, department stores, schools, and steamboats. In case the climate in some places is too cold at times to permit the use of water in the sprinkler pipes, compressed air can be kept in the pipes by means of a "dry valve," so arranged that in case

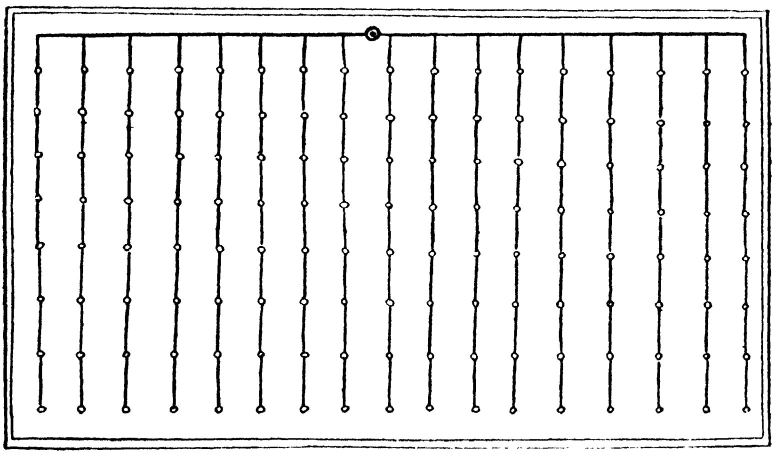

FIG. 10.—Side Central Feed to Automatic Sprinkler.

O shows a sprinkler. ⊙ shows a riser.

the sprinkler opens because of the presence of fire, the compressed air escapes and automatically permits the water to enter the pipes. The sprinkler system also contains an automatic alarm valve, so constructed that a flow of water through the same will operate an electrical or mechanical gong, or both, according as the character of the property may require. The importance of this automatic alarm arrangement cannot be overemphasized, since a large water loss may result from a small fire, which is extinguished by the sprinklers, if there is not some method of notification with a view to checking the flow.

The automatic sprinkler, as just described, is the only device known which meets all the conditions enumerated as necessary to quench a fire in its incipiency, and which thus overcomes the old and defective method of trusting to human eyes to detect a fire in time, and to human hands in extinguishing a fire after discovered. Fire underwriters and fire engineers are quite generally agreed that the automatic sprinkler is by far the most reliable and most gener-

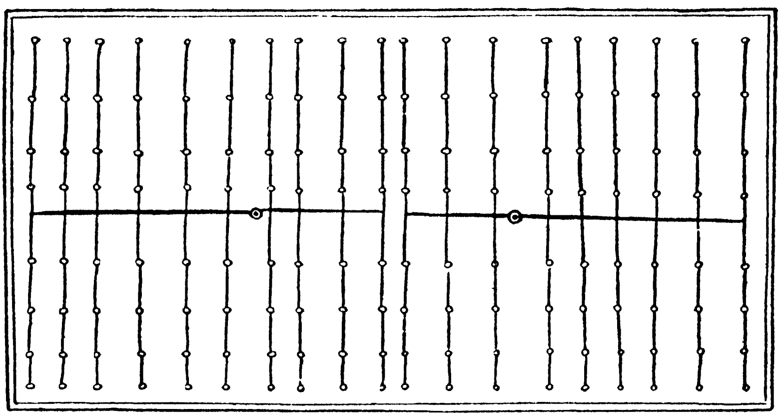

FIG. 11.—Best Method of Piping a Large Building.

O shows a sprinkler. ◎ shows a riser.

ally known of fire-fighting agencies. As Mr. Everitt U. Crosby stated in an address on the subject of "Fire Prevention": "We have had for some twenty years the sensitive automatic sprinkler protection, and yet to-day its possibilities are not realized. This type of protection is destined within a short time to be regarded generally as the apparatus-in-chief for extinguishing fires. It will be generally found in buildings having combustible construction, or contents of from moderate to large values. This branch of fire protection, more than any other, has been the subject of the most careful search, test, and specialization." The

importance of automatic sprinklers as a factor in reducing the fire waste, and consequently the cost of insurance, is confirmed by all, and especially by the glowing accounts of the factory mutuals, which have been greatly benefited by their use. Mr. Frederick C. Moore, Superintendent of the Special Risk Department of the Hartford Fire Insurance Company, presents the benefits of sprinklers, as shown by the records of 8,942 fires in risks equipped with sprinklers, and extending over a period of twelve years. In 5,791 cases the sprinklers extinguished the fire unaided. In most of the remaining cases the sprinkler system proved of value, and in only 483 cases, or less than 6 per cent of the total, did it prove of no value. The value of the system in extinguishing fires with the least accompanying damage by water is shown by the fact that 7,239 fires out of the 8,942, or 83 per cent, were extinguished with not more than twelve sprinklers opening.

*The Installation of Automatic Sprinklers.*—It is unnecessary to state in detail the rules for installing automatic sprinklers. Suffice it to say that this matter is properly regulated by the National Board of Underwriters, the New England Insurance Exchange, the New York Board of Underwriters, and other organizations. Property owners may, therefore, receive full specifications by consulting the bureau of underwriters in the particular jurisdiction in which the building to be rated is situated. A few general rules, however, are always specified in fire-prevention manuals. It is highly important that the distributing rising pipes should be of such capacity as to be proportionate to the number of orifices which are to be supplied with water. When installing a sprinkler system, it is also highly important to protect every portion of the building and to overlook none. A small room or closet not provided with sprinkler protection may easily enable a fire to gain such headway as to nullify the effect of the sprinklers situ-

ated in other parts of the building. Sprinklers can only be expected to extinguish fires when they first occur, and not when they have reached considerable proportions. Every portion of the building, therefore—closets, basements, lofts, elevator wells, understairs, etc.—should be fully protected. The building should also be so constructed as to avoid the presence of concealed spaces. The sprinklers should be sc situated that water discharged from them will reach every portion of the interior, and the construction of the building should be such as to enable the water to reach all portions of the woodwork.

It is also of primary importance that the sprinkler system should be provided with a water supply, amply sufficient and constant. It is advisable to have two sources of supply whenever possible, i.e., a large tank supply as well as a supply by a force pump or by direct connection with the city water supply. If one source fails the other may be utilized, or better still, the city supply can be used to supplement the tank supply when the latter becomes exhausted.

After a sprinkler system has been installed it is necessary to inspect the same periodically and prevent conditions which on the one hand may cause the sprinklers to fail in their work, or which may cause the opening of too many sprinklers in case of fire. There are certain conditions with which the sprinkler cannot cope, such as conflagrations, hollow spaces between ceiling and floor, and long exposure from outside fires which may reduce the water pressure. The sprinkler is also of less utility in industries where the stock consists of large quantities of inflammable liquids, or articles which shed water easily. Again, the system may be rendered defective or useless by the existence of corrosive vapors, coatings of paint, or incrustations from cement, plaster, and other articles. It follows, therefore, that a sprinkler system, even though properly installed, should be tested periodically by expert service, if absolute reliability

is desired, and should receive the same care and inspection as any other machinery in the plant.

*The Importance of Automatic Sprinklers in Reducing Fire Rates.*—Granting the effectiveness of automatic sprinklers in preventing the spread of fires, the question will naturally be asked, How may property owners, who are always viewing their business affairs from the standpoint of profit and loss, be induced to adopt this modern appliance? The answer again is, just as in the case of the other facilities discussed, that the surest way to bring about reform is to appeal to the selfish interests of property owners. If the owner of a large establishment can be convinced that the installation of an automatic sprinkler service will mean a large reduction in his fire rate, and that the saving in his fire-insurance bill will amount to more than a good investment return on the capital expended for such a service, it is only reasonable to expect that the improvement will be made.

That there is a decided saving in practically all cases cannot be questioned, although, owing to the numerous factors which enter into the installation of sprinkler systems, it is only possible to point out in a general way what the real saving is. Thus one building may be constructed in such a manner that a sprinkler may be installed with a tank supply at comparatively small expense. Another building may have been so poorly constructed as not to support a tank, and the installation of a sprinkler service in that building may necessitate much preliminary construction work at great expense. Again, the availability of a proper water supply may make the sprinkler service in one building much less expensive than in another. The representatives of the sprinkler installation companies state, that it frequently occurs because of the many varying factors which enter into the cost of such installations, that it costs as much to install a sprinkler service of a given type in a

building valued at $25,000 as it does in a building worth $100,000; and that in buildings of small value it frequently happens that the reduction in the fire rate brought about by the installation of automatic sprinklers will not show a remunerative return on the capital invested. Mr. Frederick C. Moore states that "an ordinary risk will expend $3,000 to $5,000, and large ones ten times as much. There are comparatively few risks equipped carrying less than $40,000 insurance. The average amount of insurance per risk for 126 thus equipped was $251,182."

But to regard the value of fire-preventive appliances in this light only is a short-sighted policy. Although not securing a direct return on the capital invested, many owners of moderate sized buildings are, nevertheless, entirely willing to introduce such sprinklers. They wish to avoid that great loss, so frequently overlooked, which consists of the inconvenience, the loss of time, the loss of business to competitors and its general demoralization, which is inseparably connected with every large fire. To such property owners the avoidance of such losses represents a cash value of far greater importance than a mere good investment return on the money expended. It should not be forgotten, however, that in addition to the security from loss of time and business which the property owner has bought by installing a fire-preventive appliance like the automatic sprinkler, he also secures the saving indicated by the rating schedules commonly used. This saving is a very material one, as may be seen at a glance if we consult the Universal Mercantile Schedule used in the large cities of the East. Assuming that 80 per cent coinsurance is carried, the schedule permits a reduction in the building and stock rates for mercantile risks of approximately 40 per cent of the rate, if the best type of automatic sprinkler is used, if the equipment is in compliance with the standards of the underwriters having jurisdiction as regards the number and loca-

tion of sprinklers, size of pipes, feed mains, valves, fittings, etc., and if connected with at least two approved independent water supplies, one of which must be automatic, in addition to approved outside connection for the city fire department. For special hazards the reduction in the rate generally amounts to from 50 to 60 per cent and even more, because of the existence of such sprinklers. If desiring a system, it is customary for the property owner to apply to the insurance organization of his locality, which will suggest to him in writing the plan and requirements of the system; and on the basis of this the owner can receive estimates from contractors as to the cost of the work. The owner may also ascertain the cost of insurance under the new conditions, and may thus calculate the saving he will derive from the reduction in premiums as compared with the cost of the system.

Where the building is of large size and value, the gain to be derived from the installation of a sprinkler system consists not only of the saving in loss of time and business in case of fire, but also a saving in the fire rate so large as to net an extraordinary return on the capital used. The manager of a large automatic sprinkler installation company states that he has cases on record where the saving in the total rate on the building was so large as to practically pay for the cost of the sprinkler service in two years and one day—i.e., by the time the third premium was paid. And here it should be remembered that the life of a sprinkler system, if properly cared for, is estimated to be at least from twenty-five to thirty years.

A case at hand may be cited as an illustration of the saving which may be effected by the owners of certain buildings if they introduce fire-preventive appliances. The building in question—a factory in Massachusetts for the manufacture of elevator and warehouse materials—was valued at approximately $350,000, and had an area of

approximately 50,000 square feet. The fire rate on the building when not provided with a sprinkler service was $1.50 per $100 of insurance, thus giving a total premium of $5,250, if the building was fully insured. The automatic sprinkler service, which the firm supplying this data was to introduce, provided a sprinkler for each 75 square feet of area in the building, or approximately a total of 666 sprinklers for the 50,000 square feet of area to be covered. The total cost of each sprinkler was $8 per head, including the provision for water supply, or a total cost of $5,328 for the 666 sprinklers. With this sprinkler service in existence, however, the rate on the building was to be reduced 60 per cent; that is to say, the total premium, if the building was fully insured, instead of being $5,250, was to be only $2,100, thus showing a saving of $3,150.

### THE PLANNING AND CONSTRUCTION OF BUILDINGS

The prevention of the spread of fire, after it has once obtained a good start, depends primarily upon the construction and planning of the building. From the standpoint of fire prevention, buildings are usually grouped into four main classes, viz., fireproof, semi-fireproof, slow-burning, and ordinary buildings. As regards each of these the greatest care should be exercised in planning the building. Available fire protection, such as fire-service tanks, pumps, boilers, etc., should be considered when determining the height and depth of a building. Elevators and stairways should not be located in inaccessible places, and all communications between floors should be so protected that fire may not seek these avenues in spreading throughout the building. Special hazards, such as the heating plant, should be properly isolated, and light and air should be secured without creating unnecessary exposure and draft. If the nature of the business permits, the risk should also be subdivided into several fire areas, and the most dangerous processes in the

business located where they will do the least harm to the rest of the plant or to the stock.

*Fireproof Buildings.*—A fireproof building may be said to possess four chief features. It should be of steel cage construction, and should have all of its structural members safely insulated against heat from within or without the building, or they may be of reinforced concrete construction with the reinforcing members properly insulated. All communications between floors for freight or passengers, such as stairways and elevators, should be encased in fireproof, cut-off shafts, and all horizontal tiers of windows should be fitted with wire glass in fireproof frames. A "fireproof" building should be designed so as to isolate each floor from all the others in case of fire, and if used for the storing of combustible materials should be so constructed that the contents on any floor may burn with the least danger to the building, and with the least possibility of the fire spreading to other floors. If the horizontal tiers of windows are not fitted with wire glass, the chances are that a fire on a given floor, since it cannot go up or down, owing to the fireproof construction and the protected floor communications, will be forced out through the windows, and will thus communicate to upper stories through the tiers of windows immediately above.

It is needless to say that a great many buildings called "fireproof" are not fireproof at all, and it is interesting to note how many well-informed people are imbued with the belief that non-inflammable things are fireproof, and that a fireproof building gives this characteristic to its contents. On the contrary, it is the common assertion that goods in fireproof buildings will burn fiercely—in fact, will, in many instances, burn more fiercely than when situated in other buildings. Because of this fact, it is highly important that the floors of a fireproof building should be carefully separated. This fact cannot be too strongly emphasized. Mr. F. C. Moore, in his "Fire Insurance and How

to Build," remarks: "It is probable that few subjects connected with construction are more generally misunderstood than the fireproof building. The average individual regards iron and stone as fireproof. He, at the same time, overlooks the fact, strangely enough, that glass windows are not fire resisting. Even underwriters, in estimating rates on fireproof buildings and their contents, often overlook the fact that a building intended to be fireproof, but offering nothing more substantial as a fire shield against an outside fire than ordinary plate glass in a wooden sash and frame, is even more likely to have its contents thoroughly destroyed by exposure to fire than an ordinary building of wooden joisted construction; for the fireproof structure, as already stated, holds its merchandise and other contents suspended where they will be the more effectually destroyed. The wooden joisted building, on the other hand, will probably collapse, and no small salvage may be realized out of heaps of merchandise in the cellar, so covered up that combustion would be retarded for want of air, on the same principle that a pile of wood shavings is seldom invaded by fire to a greater depth than ten or twelve inches. A further reason why the contents of fireproof buildings are so thoroughly destroyed when once ignited is that the fireproof construction, like a reverberating furnace or oven, confines the heat until extremely high temperatures are reached. Indeed, firemen who have had experience in fighting fires in fireproof buildings claim that it is almost impossible to remain on a floor where merchandise is on fire, so intense is the combustion. Everything ignitable is shriveled up. The principal advantage, therefore, of a fireproof building is the separation of the various stories from each other, and this may be largely, if not entirely, lost if the building has well-holes, or if staircases and elevators are not cut off in fireproof hallways."[1]

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[1] Francis C. Moore, "Fire Insurance and How to Build," p. 106.

It should also be noted that the public is altogether too apt to minimize the importance of exposures to fireproof buildings. The danger of fire to contents within a fireproof building is much greater because of the presence of a poor risk in the immediate neighborhood. On the other hand, a fireproof building radiates very little of its exposure to surrounding risks. "Probably no class of risks," writes Mr. F. C. Moore, is more inadequately treated in the matter of computing danger from exposures than fireproof buildings, because rating bureaus so frequently overlook the obvious fact that plate glass and wooden window frames and sashes are not fireproof, and that a so-called fireproof building offering nothing more substantial to an outside fire than plate glass has no greater fire-resisting properties than an ordinary show case would present. More than 75 per cent of the fireproof structures of the country have window openings to the extent of from 40 to 75 per cent of the superficial area of each enclosing wall, which are not protected by fireproof shutters. Heat from a burning building across a wide street finds ready entrance through such openings, and the various fireproof floors serve only to hold, like a great gridiron, ignitable merchandise in the most favorable form of distribution for ignition and combustion, to the full force of an outside fire. If fire once secures entrance to a fireproof building through the windows of any story, the contents of such a story, especially if at great height from the floor, are almost certain to be destroyed, and the danger of ignition is greater where the fireproof structure is higher than the one which is burning."[1]

*Fireproof Buildings in Recent Conflagrations.*—In the recent Baltimore and San Francisco conflagrations the fact was brought out very strikingly that many so-called "fireproof" buildings were not after all fireproof, as generally

[1] Francis C. Moore, "Fire Insurance and How to Build," p. 73.

supposed, and that there were present many deficiencies in the construction of such buildings which might easily have been averted. The statistics for the Baltimore conflagration, as far as fireproof structures are concerned, have been carefully compiled, and show that the insurance loss on such buildings was in almost the same ratio as on the ordinary buildings and combustible stock. This striking fact is to be attributed mainly to the large damage done to such buildings, and the comparatively small amount of insurance held as compared with the value of the structures. Of the seven so-called fireproof "skyscrapers" of steel-cage construction, it appears that 64 per cent, or nearly two thirds of the value of these buildings, was destroyed. This large proportion becomes still more striking when it is remembered that these seven buildings were all used exclusively for offices, and contained but small amounts of combustibles which could have caused a serious and prolonged fire. The opinion prevails among experts that, had these buildings been filled with large quantities of combustible materials, the loss would certainly have been much greater and in all probability might have been a total one. These skyscrapers were practically without any form of fire protection, partly because there was no apparent need for the same, and partly because of the impossibility of the fire department being able to approach them during the conflagration.

In San Francisco, likewise,[1] the conflagration tested thoroughly the various types of fireproof steel structures, and gave to the world a most valuable lesson as to the future construction of such buildings. Terra cotta, so generally used in San Francisco, was shown to be wholly inadequate. Wherever steel work was protected by terra cotta, the cover-

[1] See the *Special Report to the National Board of Fire Underwriters, Committee of Twenty, on the San Francisco Conflagration*, by S. Albert Reed, Consulting Engineer to the Committee.

ing was in nearly every case torn off and destroyed. As stated in one of the reports on the durability of different fireproofings in the San Francisco fire: "When terra cotta was used the partitions fell down, the fireproofing around the columns came off, and a very large proportion of the floor arches either fell out or the bottom plates of the arches broke off and left the arches in a very bad shape." In most cases the fireproofing of columns was of terra cotta. With the destruction of the column covering by the excessive heat, little protection was left, and the result was that very few buildings in San Francisco did not present the sight of badly bent or buckled columns.

As contrasted with terra cotta, concrete stood the test of the conflagration well in nearly every instance, little or no damage resulting to steel work which was fireproofed with this substance. Another form of column covering, which withstood the fire well, consisted of two thicknesses of wire lath and plaster, with an air space between them. While in many cases the outside covering was torn off, it seems to have resisted the fire during the most intense stage, thus enabling the inner covering to protect the column.

The best material for the construction of walls is hard burned brick. Stone, contrary to common opinion, is a very undesirable building material, and if used extensively, especially for supporting heavy weights, may serve as a means of wrecking the entire building. One of the most prominent fire underwriters in the country, in speaking of this, declares that: "The best fire-resisting materials for walls, it may safely be asserted, is hard burned brick. It is also the best material for the floor arches between the iron beams of fireproof buildings. It is incomparably better than stone, because stone is utterly unreliable for resisting fire, especially the limestones, granites, marbles, etc. In fact, stone is a dangerous material wherever it is subjected to fire and water, and carries a heavy superimposed weight."

Of all the materials used in the fronts of the buildings in San Francisco, stone showed by far the worst effects of the recent conflagration. In the Postal Telegraph Building the granite columns in the first story almost entirely disappeared through the splitting and crumbling of the stone. According to one official report: "This is true of every place where the flames or heat touched the stone; it spalled off and left the fronts in such a bad condition that they will probably have to be taken down." Terra cotta did not resist the effects of heat and fire much better than stone.

*Semi-fireproof Buildings and Slow Burning Buildings.*—Semi-fireproof buildings differ from fireproof buildings in so far that, while constructed of non-inflammable material, they are equipped with structural or tension metal members, which are not properly insulated against heat. These buildings are constructed because of their greater cheapness as compared with fireproof buildings, and because the prevailing building code in many cities does not prevent their erection. They are constructed very often to serve for office purposes or as dwelling apartments, or for other uses of a similar character, in which it is presumed that the limited amount of combustible stock which they contain will make it extremely unlikely that sufficient heat will be generated to seriously injure the ironwork in the building.

Slow-burning or "mill construction" buildings are to be distinguished from semi-fireproof buildings. The floors in slow-burning buildings are without openings, and consist of heavy plank laid on heavy timbers, spaced from 5 to 12 feet apart, such timbers resting on stout wooden posts. It is also prescribed that there must be a tight top flooring, with waterproof paper between it and the plank flooring below, which must never be less than 3 inches in thickness. The aim of such requirements is to separate the different stories by a floor of considerable thickness so that, though large stocks of combustible material may be contained in the

building, it will require several hours under normal conditions for a fire to burn through the flooring. Before this is accomplished it is presumed that the fire department will be able to get the fire under control and prevent its spread.

*Fire Doors and Shutters and Wire Glass.*—A number of special features must be noted in the construction of buildings designed to retard the rapid spread of fire. The first of these is fire doors and shutters. The door now commonly used is made of wood covered with metal and provided with special lock-jointed tin plates. The idea is to allow the wood to carbonize in case of great heat, and to permit the gas resulting from the carbonizing of the wood to escape through the lock joints instead of permitting it to accumulate and throw off the metal sheets. As the wood carbonizes the charcoal will drop to the bottom of the metal covering, but the metal will hold together, thus preventing the passage of the fire.

Wire glass is also of considerable importance. It gives splendid protection when the sash is fireproof and when the glass is double with an air space between. Wire glass in most cases serves a better purpose than shutters, because the latter must not only be closed to become effective, but will deteriorate if not properly cared for. Moreover, where there is not an exposing risk to be guarded against, shutters are regarded by many underwriters as a nuisance. It should be remembered, however, that wire glass radiates heat, so that in case of a severe exposing fire it may happen that combustibles within the building and near the glass may ignite. In this respect wire glass is inferior to well-designed shutters.

# CHAPTER XXI

## STATE SUPERVISION AND REGULATION

Beginning with the famous case of Paul *vs.* Virginia, decided in 1868, the United States Supreme Court has again and again asserted the doctrine "that there is no doubt of the power of the state (using that term as contrasted with the Federal Government) to prohibit foreign insurance companies from doing business within its limits. The state can impose such conditions as it pleases upon the doing of any business by these companies within its borders, and unless the conditions be complied with the prohibition may be absolute." Because of its broad jurisdiction over all foreign relations, the United States government, in theory at least, possesses the power to exclude or expel alien corporations from all parts of the country; likewise to admit them without regard to the regulation of the States. In actual practice, however, an alien insurance corporation wishing to do business in the United States first seeks admission to a certain state. By complying with its laws it establishes therein its headquarters for American business; and then, if business warrants, seeks admission to other states. Indeed, to such an extent has the jurisdiction of the several states over alien insurance companies been recognized that the Executive Department of the United States has not seen fit, in the absence of a treaty stipulation covering the subject, to consider a complaint of unjust discrimination lodged by an alien company against a state, and has expressed the view that the regulation of insurance corpora-

ations by federal treaty would not be sanctioned by the representatives of the states.

Acting in accordance with the numerous decisions of the United States Supreme Court and the policy of our Executive Department, the several states and territories of the United States, including the District of Columbia, have each assumed full supervisory powers over all alien and domestic corporations transacting an insurance business within their borders. In most of the progressive states this control has been entrusted to a supervisory officer, known as the Superintendent or Commissioner of Insurance, who, in nearly all cases, is appointed by the governor, and who is placed in charge of a separate department of the state government. In this matter, however, there is by no means uniformity among the states. In a number of states, including some of the large and wealthy ones of the West and South, the work of supervising insurance companies is left to the auditor or comptroller of the state, and, as we are informed, is "ministered oftentimes in a most perfunctory manner by the same machinery that is furnished by the state for looking after building and loan associations, savings banks, county treasurers, and the like." In certain other states and territories the work of supervising insurance companies is left with the secretary of state, while in a few the state treasurer is the supervising officer. In twenty-five states and territories at a recent date there had not as yet been established a separate insurance department, and the responsibility of supervising insurance companies was attached to some other department of government.

Although the legislatures and courts of the several states, as we have seen, play a prominent part in the enactment and interpretation of insurance legislation, the actual supervision of the companies and the enforcement of the laws is performed by the insurance commissioners. These officials, to say the least, are vested with extraordinary discre-

tionary powers in the matter of application. Among other things, the commissioner of insurance must see to it that all the laws of the state respecting insurance companies and the agents thereof are faithfully executed, and that all the companies are in a solvent condition according to some fixed standard. No foreign company may transact business within the state without his permission, and no person may solicit business for such companies without the commissioner's certificate of authority. Every company must render an annual statement of its condition and business in the form and manner prescribed by the commissioner. He is also given power to require at any time statements concerning any company doing business in the state, from any of its officers or agents on any points he may choose to ask. For purposes of examination, he is empowered to require free access to all books and papers within the state of any insurance company, or the agents thereof, doing business within the state. He may summon and examine any person under oath relative to the affairs and conditions of any company; and for probable cause may visit at its principal office, wherever it may be, any insurance company not of a state in which the substantial provisions of the law of his own state shall be enacted, and doing business in the state, for the purpose of investigating its affairs, and may revoke its certificate if it does not permit such examination. Neglect or refusal on the part of the company to render any statement means a cessation of its new business, and neglect to furnish information within the time and manner prescribed by the commissioner usually subjects the company to heavy money fines.

Power is also given the commissioner to suspend the entire business of any company by revoking or suspending its license if in his opinion the company does not comply with any provision of the law, or whenever its assets appear to him insufficient. He must see that the company has

made the proper deposits of approved securities; that it makes a correct return of the taxes which are imposed by law; and that a resident of his state is appointed the attorney of the company so that in the event of litigation legal process may be served without the citizens being obliged to go outside of the state to serve the papers. It is also his duty to calculate the reinsurance reserve for unexpired fire risks, and to see that the assets of all companies organized in the state are properly invested in the form prescribed by law. He has supervisory powers over the organization of all companies from the time that the articles of agreement are arranged until the company is ready to begin the writing of policies, and in every stage of the organization and in all matters pertaining thereto, it is necessary for the organizers of the company to have his approval. Finally, he owes it to the public as well as to the insurance companies to do all in his power to exterminate improper or unlawful insurance schemes. Numerous other duties and powers might be enumerated, but those mentioned will suffice to show that the insurance commissioner is clothed with extraordinary powers, and that consequently the personality of the commissioner is a factor, the importance of which cannot be overestimated.

*State Supervision in Practice.*—Directing our attention now to an examination of how state supervision works in practice, it seems to be generally conceded that it has proved expensive and annoying. First of all, attention should be directed to the multitude of taxes and fees to which the insurance business is subjected, variously estimated at from $20,000,000 to $25,000,000 annually, and to which fire-insurance companies contribute a very respectable share. This huge sum comprises a variety of taxes, annual license fees, agency fees, fees for filing papers, charters, and the like, and in some states municipal license fees. These charges in too many instances do not bear any direct relation

to the service rendered by the state. A compilation of data for twenty-eight states made four years ago showed that, exclusive of all taxation, these states collected $5,000,000 more than was required to meet the expenses of their insurance departments. In fact, as has been frequently pointed out, some of the state insurance departments have developed into little more than tax and fee gathering and salary-earning institutions.

Furthermore, a study of the insurance laws of the several states will show a conspicuous absence of method or uniformity in their tax policy. Some states tax gross premiums after deducting losses and expenditures of various kinds, but many others tax gross premiums without any such deduction. The rate on gross premiums varies all the way from 1 per cent in some states to 4 per cent in others, and the variety of additional fees and minor charges is almost beyond description. Many states provide for a greater tax rate against foreign companies than domestic companies, and some, in turn, provide for a higher rate against alien companies than companies of other states. Then, again, there are the so-called retaliatory laws existing in some thirty-two states of the union, which provide, to quote the recent Minnesota law of 1907 (chapter 420), that "whenever, by the laws of any other state or country, any taxes, fees, deposits, penalties, licenses or fees, in addition to, or in excess of those imposed by the laws of this state upon foreign insurance companies and their agents doing business in the state, are imposed upon insurance companies of this state and their agents doing business in such state or country, or whenever any conditions precedent to the right to do business in such state are imposed by the laws thereof, beyond those imposed upon such foreign companies by the law of this state, the same taxes, fees, deposits, penalties, licenses and fees and conditions precedent shall be imposed upon every similar insurance company of such state or coun-

try and their agents doing business or applying to do business in this state, so long as such foreign laws remain in force." As has been aptly said concerning such laws, the insurance commissioner must "exercise that relic of barbarism known as the retaliatory law, whereby he is compelled to say in practice to the corporations of other states, 'because your laws impose unjust and onerous conditions upon my corporations I will act in the same unjust and arbitrary manner toward you.'"

But quite as burdensome as the tax abuse and the expense of supervision is the absence of uniformity in insurance legislation. If a compilation of all the state insurance laws were attempted, a spectacle would be presented as curious as it would be instructive. The fact which would stand out above all others would be the extent to which the states are acting according to their own sweet will, each possessing "its own schedule of taxes, fees, fines, penalties, obligations, and prohibitions, and on top of it all a retaliatory provision enabling it to meet the highest charges any other state may require of companies of other states." Each year witnesses the enactment of a multitude of new laws by the state legislatures; also a change in numerous existing laws, as well as the introduction of a large number of bills never intended to become law.[1] In fact, bills affecting the interests of insurance companies in one way or another are said to be introduced in our state legislatures at the rate of approximately six hundred a year.

Especially in fire insurance have the evils of state legislation become clearly apparent, and every fire underwriter will agree that there are many laws in existence which not

[1] For an illustration of this voluminous and varied character of insurance legislation see the annual "Review of Insurance Legislation," prepared by the author, for the years 1905, 1906, 1907, and 1908, for the New York State Library Bulletins on the Review of Legislation for the respective years.

only prove exceedingly annoying to the companies without affording any benefit to the public, but which in many cases are distinctly detrimental to public interests, besides being at variance with the laws of neighboring states. For years fire-insurance underwriters have striven to secure the adoption of a standard fire policy throughout the United States. Yet only one third of the states have thus far adopted such a policy as a matter of law and made it obligatory. Where used, the provisions of the policy have occasioned much litigation, and have been variously interpreted by the state courts, so that, as we have seen, some of its provisions are prohibited altogether in some states, mean one thing in another class of states, and have a very different meaning in a third group of states.

Consider almost any of the many important provisions of the New York standard policy, and it will be found that there exists an amazing diversity of judicial opinion, and in certain instances considerable hostile legislation. This is true as regards the conditions in the policy concerning a change in location of the insured property, or the liability of the company in case of total loss or for excluded risks. It is also true as regards the warranty clause, the waiver clause, the clauses pertaining to the rights and duties of agents, the clauses pertaining to notice of loss, the appraisal and settlement of losses, the bringing of a suit or action on the policy before full compliance with its provisions, etc. To be specific, while the policy limits the liability of companies to the actual cash value of the property at the time any loss or damage occurs, and while the theory and practice of fire insurance shows that this is the only correct and sensible way, yet some twenty states have enacted so-called "valued policy laws," according to which the amount of recovery is determined in certain cases not by the loss at the time of the fire, but by the amount of insurance named in the policy. It is generally admitted that such laws are conducive

to fraud and injurious to the property owner's interests. Despite this fact, it is interesting to note that between 1891 and 1903, inclusive, 213 valued policy bills were introduced in the several state legislatures, resulting in the adoption of such laws by nearly one half of the states. The policy expressly provides that it insures "the following described property while located and contained as described herein, and not elsewhere." And yet, as has been pointed out in a previous chapter, this apparently unambiguous provision is strictly enforced in some states, and so liberally construed in others as to protect property in many cases, even though removed to another location. Again, the policy forbids the keeping on the insured premises of a large number of specified explosives and highly inflammable substances, "any usage or custom of trade or manufacture to the contrary notwithstanding." Yet the courts of some states have rendered this important provision inoperative in special instances, and again have applied it differently in various states. While the appraisal clause of the policy is upheld in some states, the courts of other states regard it as purely optional and revokable by either party. In many states the policy provisions referring to agents are strictly enforced, yet in other states the courts will hold that notice to the company's agent in a manner definitely prohibited by the terms of the policy is, nevertheless, binding upon the company. In some seven or eight states there even exist laws prohibiting or restricting the use of the coinsurance clause.

Illustrations like these might be indefinitely multiplied. "Upon many questions," as reported by the Insurance Law Committee of the American Bar Association, "the federal rule differs from that of the state courts, and the anomalous situation is often presented that upon precisely the same facts the judgment of the federal court will be exactly opposite to the judgment of the state court of the same federal

district." Again the committee reports that "in a number of the states there are statutes requiring all insurance companies of other states to agree not to remove any suits against them to the federal court under penalty of a forfeiture of their license. A measure of that kind is based either upon malice against insurance companies or want of confidence in the federal judiciary. The first reason is necessarily a bad one, and the second reason shows an unfortunate condition of affairs. Whether the fault be in the federal judiciary or in those who have no confidence in it, the result is a conflict between the state and federal courts and between the state and federal government. Such statutes attempt to accomplish by indirection what cannot be done directly, for the right to litigate in the federal court under the conditions prescribed by the Constitution of the United States, and the acts of congress pursuant thereto cannot be waived."

In addition to the above criticisms there should not be forgotten some of the evils which are the necessary result of supervision on the part of some fifty different states, and which grow out of the different demands and rulings of insurance commissioners of the same state as well as of different states. No feature of the present system of state supervision seems to call forth so much criticism from the managers of important fire-insurance companies as this. Their opinions, as expressed in letters, show that with scarcely an exception they regard the lack of uniformity in the practice of supervision, and the multitude of varying state requirements with reference to the rendering of reports and statements as a needless and annoying burden. The several insurance commissioners, it is true, have made numerous attempts to secure uniform statements, yet no fact is asserted more frequently by prominent fire underwriters in connection with this matter than that the commissioners do not seem to be able to agree on any one form of statement, and that

each state has some supplementary requirements which unnecessarily increase the trouble and expense of furnishing annual statements. Finally, there is the right, leading at times to duplicate and uncalled-for examinations, of the insurance commissioner to examine a company at will, and at the company's expense. Being authorized, generally to revoke the license of a company for failing to comply with his orders and demands, his power over companies is necessarily one of vast influence; and, as a rule, compliance with all except conspicuously unfair demands is preferred by the companies to the trouble which would ensue in case of refusal.

*State vs. Federal Supervision.*—As a remedy for many of the imperfections of the present system, many have advocated the substitution of federal for state supervision. The movement for federal supervision of insurance companies has existed in one form or another for half a century, and while supported chiefly by life-insurance companies, fire underwriters everywhere have manifested a keen interest, and every important bill on the subject introduced in Congress has contemplated the extension of federal supervision to fire-insurance companies. To understand clearly what the change from state to federal control means, it should be stated that the advocates of federal supervision intend to have the national government regulate all insurance transactions between the states, but do not propose to interfere with the constitutional right of the states to supervise their own home companies.

A law to this effect, if constitutional, would radically alter present conditions. Besides subjecting interstate insurance to all the federal statutes applying to interstate commerce, it would free interstate insurance from many of the vexatious burdens of state control already described. Since the states cannot restrict interstate commerce, federal supervision would render inoperative the large mass of state

laws discriminating against foreign companies or otherwise governing their admission and expulsion. If constitutional, the new system would also mean that every company, in order to do business beyond the state of incorporation, must obtain a federal license which will enable it to transact business throughout the country. Likewise, as regards the collection of millions of dollars of fees and taxes by the states from foreign companies, a radical change would seem likely to follow. To quote from Mr. C. F. Randolph's excellent paper on this subject (*Columbia Law Review*, November, 1905): "The withdrawal of state supervision will, of course, withdraw these charges; and all license fees will fail, for interstate commerce cannot be subjected to a privileged tax. A state will retain power to tax a company's real and personal property within its jurisdiction at equal rates with like property, but this tax is comparatively unimportant. The chief interest centers upon taxes on the business of insurance, commonly imposed on the premium receipts."

The changes thus outlined, which will follow the introduction of federal supervision, are of the greatest significance, since by far the greater portion of the insurance business is interstate or international in character. In the state of New York the fire-insurance companies with risks of $50,000,000 or more write only about one fourth of their business in the home state, and collect from this business only about one fifth of their premium income. The same companies in Pennsylvania write only about one tenth of their business in the home state. To this fact it must be added that a very large proportion of the country's fire and marine insurance is written by alien corporations. We are informed that "one third of the fire insurance written in this country is written by British corporations, and an additional 7 per cent by American corporations owned and controlled by foreign insurance companies." Likewise in marine insurance alien corporations write over 50 per cent of the total business

written in this country, and collect nearly one half of the total premiums.

It would seem, thus, that the insurance business is peculiarly interstate and international in character, and is peculiarly fitted for federal control, especially in view of the inadequacy of the present system of state supervision and the changes which it seems very likely will be ushered in with the establishment of federal regulation.

But the opponents of federal supervision argue that all the predictions for the change rest on conjecture and await demonstration, that the states cannot be induced to give up their control, and that, above all, there is the controlling fact that the Supreme Court of the United States has, beginning with 1868, again and again declared that insurance is not a subject for federal control.[1] Congress can only exercise those powers delegated to the United States by the Constitution; and the supervision of insurance, if delegated at all by the Constitution, it is generally conceded, finds its legal sanction in Section 8 of Article I, namely: "The Congress shall have the power to regulate commerce with foreign nations and among the several states, and with the Indian tribes." To bring federal supervision of insurance within the scope of this clause, insurance must be declared to be commerce. And here it is pointed out that even as late as 1901, in the case of Nutting *vs.* Massachusetts, the Supreme Court affirmed its many previous decisions in the following words:

"A state has the undoubted power to prohibit foreign insurance companies from making contracts of insurance, marine or other, within its limits, except upon such conditions as the state may prescribe, not interfering with interstate commerce. A contract

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[1]Paul *vs.* Va., 8 Wall., 168 (1868); Liverpool Co. *vs.* Mass., 10 Wall., 566 (1870); Hooper *vs.* Cal., 155 U. S., 684 (1894); N. Y. Life Ins. Co. *vs.* Cravens, 178 U. S., 389 (1899); Nutting *vs.* Mass., 183 U. S., 553 (1901).

**of marine insurance is not an instrumentality of commerce, but a mere incident of commercial intercourse."**

The force of this claim of unconstitutionality must be fully recognized, and it has been the great stumbling-block in the way of federal supervision ever since agitation for that measure began in 1868. It cannot be removed except through a test case or by amendment of the Constitution. Until some action is taken by Congress, or until a suit is brought by a state against a foreign company refusing to be regulated, there will continue to be those on the one hand who maintain that the "insurance cases" are conclusive against national supervision; and, on the other hand, those who hold that none of these cases involved the constitutionality of a federal law, but were merely concerned with state laws; that the cases are to be regarded as mere dictum and do not justify a negative policy; that constitutional objections have been raised against most of the country's greatest legislative measures; that the Constitution is a growth to meet the needs of the time; that the Supreme Court has frequently reversed its rulings; and that if Congress should act by passing a law, and the whole matter be squarely brought before the Supreme Court for decision on its real merits, the necessity of the situation would warrant a hope for a favorable decision.

Again, it is argued, that there are recent cases to show that the Supreme Court has already retracted in large measure from its earlier position on this question. Chief reliance is placed on the lottery case of February, 1903, where it was decided by a vote of five to four that a lottery ticket is an article of commerce. This decision, it is argued, greatly weakened the force of "the insurance cases." Indeed, the four dissenting judges—Justices Fuller, Brewer, Shiras, and Peckham—did find a sufficient similarity between a lottery ticket and a policy of insurance to hold the majority opinion

at variance with the "insurance cases," and their dissenting opinion contained these significant words: "Is the carriage of lottery tickets from one state to another commercial intercourse? The lottery ticket purports to create contractual relations, and to furnish the means of enforcing a contract right. This is true of insurance policies, and both are contingent in their nature. Yet this court has held that the issuing of fire, marine, and life insurance policies in one state, and sending them to another, to be there delivered to the insured on payment of premium is not interstate commerce." In answer to this dissenting opinion the opponents of federal supervision argue that the definition of a lottery ticket by the court differs essentially from that of a policy, the first being defined as a subject of traffic, something that could be bought and sold, while policies of insurance were considered in Paul *vs.* Virginia as not "subjects of sale and barter, offered in the market as something having an existence and value independent of the parties in them."

*PART TWO*

# MARINE INSURANCE

# CHAPTER XXII

## THE DEVELOPMENT OF MARINE INSURANCE

MARINE insurance is far more technical and complex than any other system of indemnity. Fire insurance provides against loss occasioned by a single occurrence. Life insurance insures against an event, the occurrence of which is inevitable, and the risk concerning which has been approximately measured by the application of the law of average to accumulated data. Marine insurance, however, undertakes to indemnify a person against the loss of ship, goods, freight, anticipated profits, or any other insurable interest, through any of the numerous perils and adventures connected with navigation, such as the "perils of the sea," fire, collision, pirates, thieves, seizures, and restraints, jettison, barratry of the master or mariners, and all other perils, losses, or misfortunes which may be assumed by the policy.

While determined efforts have been made for years, and with success, to place life and fire insurance upon a scientific basis, this can be said of marine underwriting to only a limited degree. Some of our leading marine companies do possess a great mass of experience which is used as a basis in computing rates. Yet, taking the business as a whole, there is no other branch of insurance in which success is so largely dependent upon the native sagacity, the keenness for observation, and the general specialized ability of the individual underwriter to know not only men, but the effect of climate, seasons, geographical localities, and numerous other considerations upon any of a large number of risks, as in marine insurance. To a very large extent the business is

inherently a system of estimates, and the importance of the personal qualities of the underwriter cannot be over emphasized.

It is this complex nature of the business which is responsible for the fact that marine insurance is to-day a comparatively little known business to the general public. Consult any of our leading insurance journals and a score or more of pages will be found dealing with other lines of insurance for one dealing with this, the oldest and possibly the most interesting, and, in many particulars, an equally important branch. This comparative absence of notice, however, should not cause us to overlook the fact that in this country alone, between six and seven billion dollars worth of property is insured under marine policies, and that it is through this form of insurance that commerce is enabled to become general and continuous. People would not risk their fortunes in enterprises surrounded with so many dangers as are mercantile ventures, were it not for the indemnifying contract of marine insurance, which in distributing the losses of a few among the many, removes the sense of fear and makes the shipping industry one of certainty in its results, instead of a half gambling enterprise. As William W. Bates states: "Marine insurance bears to commerce the relation of bodyguard rather than of mere servile attendant. . . . Of the active forces which influence, control, or forbid the employment of shipping, none have greater effect than the marine-insurance power."[1] Marine underwriting may, indeed, be ranked as just as much an instrumentality of commerce and almost as necessary to navigation as the ship itself.

To this it may be added that, as the methods of conducting oversea trade are being constantly transformed, marine insurance is becoming an increasingly important adjunct of commerce. As Mr. Gow writes: "When large transactions

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[1] William W. Bates, "The American Marine," p. 219.

are worked, as is now extremely common, with credits and margins, the amount of the premium of insurance is often the item that decides whether some venture will be attempted or not. The protection which marine insurance affords is now usually regarded as an absolute necessity to the oversea merchant; and thus by degrees, marine insurance has become in one shape or another an integral, almost an essential factor in oversea commercial transactions."[1] It should also be stated that, as compared with other property, a greater risk of loss attaches to property afloat. Furthermore, our carriers on land, because of their greater magnitude, can consider loss of cars, locomotives, or freight as a part of their operating expenses, partly because the losses are rarely large in comparison to their total assets, and partly because they average approximately a certain definitely known amount. In the case of water transportation, however, the companies are, except in a limited number of cases, not nearly so large, and a single disaster may spell ruin. Again, our common carriers on land are usually held liable in law for loss or damage to goods while in transit. Water transportation companies, on the other hand, are liable for such loss to only a limited degree, and the shipper must, therefore, seek protection in the form of a marine policy.

*Early History.*—Marine insurance may be regarded as the earliest form of indemnity, antedating other kinds of insurance by many hundred years. Even centuries before the introduction of marine underwriting, as we know it to-day, the commercial nations of the ancient world secured the benefit of insurance through the so-called "loans on bottomry," e.g., loans made on the security of the ship and cargo at high rates of interest, and with the understanding that the principal, with interest, was to be repaid only in the event of the safe arrival of the vessel, and that the lender

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[1] William Gow, "Marine Insurance," p. 2.

was to forfeit both principal and interest in case of loss. Instead, then, of paying a premium before starting the voyage, as is now the case, and receiving the indemnity after a loss is incurred, the insured, under the bottomry loan, received the indemnity in advance and only returned the same plus a premium after the safe termination of the voyage.

Such loans on bottomry were especially entered into by members of the Roman nobility, who, too proud to interest themselves directly in commerce and yet desirous of attaining large interest returns, could here find a convenient method of investing their funds profitably, and at the same time avoid engaging personally in mercantile pursuits. That such loans were prevalent among the commercial nations of early history is shown by the numerous references to such transactions which are found in the legal literature of the Romans. In an edict of the Roman Emperor Justinian of A.D. 533, for example, the rate of premium on such loans was fixed at 12 per cent, implying that the practice must have been very general at that time. It should be borne in mind, however, that this method of indemnification is the only one approximating modern insurance of which antiquity furnishes us any clear and direct evidence. It is remarkable, indeed, that nations so far advanced in their legal systems, as were the Mediterranean countries, and with such extensive commercial interests, should have left us no direct and conclusive evidence to show that they at all understood marine insurance as now practiced.

Marine insurance as it exists to-day originated at a much later date than the loan on bottomry. Evidence seems to show that it had its start in Italy, especially among the Lombard merchants, at the close of the twelfth and the beginning of the thirteenth century. From thence it spread to Flanders, Portugal, and Spain during the fourteenth and fifteenth centuries, and was finally carried to England by the Lombards in the early part of the sixteenth century.

Following its introduction in England, marine insurance spread to the various commercial centers of Europe, its application becoming very general, if judged by the consideration given to the subject in the numerous commercial codes and ordinances of the fifteenth, sixteenth, and seventeenth centuries. Finally, there followed the epoch-making Ordinance de la Marine of 1681, which became the model for practically all the modern codes of commercial law on the continent, including the law of marine insurance. In England, on the contrary, the development of the law concerning sea insurance did not begin to assume such clear and definite form until almost the middle of the eighteenth century. It was then that Lord Mansfield, in his efforts to formulate the commercial law of England, began to draw his legal principles very largely from the commercial ordinances and codes of the continent with a view to applying them to English conditions. His decisions practically constitute the foundation of marine insurance law in England, and, in turn, have become the basis of American decisions. As supplementing this lengthy and continuous legal development, it is important to note that the Lloyd's policy prevailing in England today is very similar to the policy which was in use in the early part of the seventeenth century, and that many features of the English policy have in turn been incorporated in the policies used in America. In other words, we have in marine insurance several centuries of usage and judicial interpretation relating to the signification of a single document.

*Development of Marine Insurance.*—Turning to the financial development of the business as distinct from the legal, marine insurance has reached its broadest scope and highest efficiency in the United Kingdom. Its history in that country, whose merchant marine for many decades comprised nearly half of the ocean-going tonnage of the world, has been rendered famous by the close identification of the business with the world-renowned corporation of Lloyd's. This gigan-

tic institution had its origin in a mere seamen's coffee-house, established by Edward Lloyd near the middle of the seventeenth century. This enterprising and energetic man besides making his coffee-house a convenient place of meeting for merchants and seamen, also created an elaborate system of home and foreign correspondence to supply him with news from all the leading ports of the world concerning the movements and character of vessels for the information of his patrons. In fact, at first the underwriting of marine risks was a subordinate feature of his business. The systematic manner, however, in which maritime information was collected and disseminated soon won for him a large following, and made his coffee-house, among the many other existing in London, the principal meeting place for merchants and professional underwriters who, unhampered by any rules or regulations, assembled there and transacted a general marine business. Thus it came to pass that Lloyd's soon outgrew its early usefulness, was transferred in 1692 from its original location in Tower Street to Lombard Street, and finally, in 1794 to the Royal Exchange of London, and there developed into the chief center of marine insurance in the United Kingdom and in the world.

It is not to be inferred from this account that marine insurance in the United Kingdom is confined to Lloyd's. Prior to the beginning of the eighteenth century the business was conducted almost entirely on the plan of Lloyd's, according to which individuals assumed risks upon the strength of their personal honesty and financial standing. In fact it was the practice of various individuals subscribing their names to the insurance contract for a certain portion of the total risk that gave rise to the familiar term "underwriter." But gradually companies began to participate in the same business that Lloyd's was pursuing. The movement seemed to gain strength rapidly, when, in 1720, the British government in return for a payment of £300,000 to the Exchequer

limited the privilege of insuring marine risks to only two companies besides Lloyd's, namely, the London Assurance Corporation and the Royal Exchange Assurance Corporation. Shortly after, however, this monopoly was removed; and since then, especially during the nineteenth century, numerous corporations in London, Liverpool, and Glasgow, with vast accumulated assets, have risen alongside the unique and unrivaled corporation of Lloyd's, and, like that institution have extended their influence to all parts of the earth. So effective, in fact, has the competition of the powerful insurance companies become that Lloyd's, although still the center of attraction in the marine-insurance business, has gradually lost the dominating influence of former days. It is estimated that Great Britain to-day transacts about three fourths of the sea insurance of the world, a proportion so large that one can look for an explanation only to the preponderating importance of Great Britain as a shipping nation.

*Development of Marine Insurance in the United States.* —Marine insurance in the United States has had a development radically different from that in England. The business has been conducted almost altogether by corporations, the Lloyd's system of underwriting, though often tried, having never obtained a prominent foothold in this country. While British companies have had a long and prosperous career, the companies of the United States, with few exceptions, have either failed or changed the character of their business. The development of the business in this country may be conveniently divided into four main epochs, each with distinctive characteristics of its own. The dates of these periods may be placed roughly at 1793, as marking the end of the first period; 1793 to 1840, as indicating the limits of the second period; 1840 to 1860, the third; and 1860 to date, the final period.

During the first period, extending to the end of the eighteenth century, the only form of insurance upon goods or

vessels was by personal underwriting. Resort was had at first to the private underwriters of Great Britain, frequent mention being found in earlier colonial correspondence, of indemnity for American shipping. The business transacted by Americans was confined to underwriting by individuals or partnerships only, who generally represented wealthy citizens of the community. It was not until the year 1794 that the General Assembly of Pennsylvania chartered the Insurance Company of North America, the first stock company of its kind upon the continent whose name it bore. Fortunately this pioneer company was launched at a time when Philadelphia was still the commercial metropolis of the country, with its shipowners and merchants trading in all the remote corners of the globe, and, therefore, large purchasers of insurance. It was not long before the brokers, who previously had had the American business to themselves, found that their patrons preferred the stability of corporate underwriting on a large scale to the underwriting of individuals. In the very first year of active business, the company refused to write for private offices, and "realizing its strength made public advertisement of their rules, and invited orders to be addressed directly to the company."[1]

This important step toward the establishment of corporate underwriting with all its advantages was soon to serve as a model for similar undertakings in other parts of the country, and before another decade had passed the insurance Company of North America was to have active associates in its own home as well as in New York, Boston, Baltimore, Charleston, and other places. So rapid was the movement of incorporating insurance companies that prior to 1800 thirty-two insurance companies had been established in this country, of which ten were doing a marine business. By 1811 there existed in Philadelphia alone eleven companies,

[1] "History of the Insurance Company of North America," p. 56.

seven of which were marine companies and one a fire-marine company, while by 1825 there were twelve marine stock companies in New York and at least a dozen in Boston.

Prior to 1830 the history of these companies may be characterized as one of periodical prosperity and depression. If judged by the experience of the largest company (and this is typical of most other companies) business exhibited the greatest fluctuations. Thus during the first decade of its history, ending with December, 1802, the Insurance Company of North America collected premiums of $6,037,456, and paid losses of $5,500,887, leaving a margin of less than 9 per cent for expenses, while the decade ending in 1812 shows, premiums of only $1,364,637, or only one fifth the income of the first decade, and losses of $1,583,836.47. These remarkable fluctuations, as also the decrease in the annual premium receipts and the increase of the ratio of loss to income are to be explained, partly by the growing competition arising from the numerous rival institutions which were springing up everywhere; partly because insurance managers had not yet mastered the lesson of accumulating a large surplus, and very imprudently distributed all profits to stockholders without making provision for the heavy losses of the immediate and stormy future; but mainly to the heavy losses connected with the Napoleonic Wars. This series of bitter struggles with its blockades and counter-blockades, affecting practically all of commercial Europe, subjected American commerce to unusual risks and losses. Insurance was consequently in great demand, and came for the first time to be regularly adopted by all shipowners, and at rates which averaged as high as 12 per cent. But while the business of marine insurance received a strong impetus during this period of strife, it was of uncertain tenure, being constantly subject to heavy losses arising from capture, detention, and litigation. A list compiled by Mr. Seybert from a report of the Secretary of State shows that the total captures

of American vessels by the British, French, Neapolitans, and Danes during the years 1803 to 1812 aggregated nearly 1,600, the major portion of which were condemned, and most of the others detained. In those days of slow communication it would often happen that a company might be incurring heavy losses at the hands of foreign cruisers without being able to obtain knowledge of the same for months, in the meantime assuming new risks equally exposed to the attacks of the enemy.[1]

With the cessation in 1815 of the Napoleonic Wars and the introduction of a period of profound peace, one might suppose that the business would have immediately revived. But such was not the case. The high war rates gradually gave way before low peace rates, and by 1820 these were the general rule. By this time, too, personal underwriters had been almost entirely displaced by underwriting corporations whose number had greatly multiplied in all the leading seaports. To make matters still worse, in view of the rapidly declining rates, these numerous corporations began to wage a fierce and incessant competitive war against each other. The elimination of the personal underwriter meant the establishment of the broker as middleman, and soon the numerous companies in the various leading commercial centers no longer confined their business activity to their own locality, as they had done heretofore, but began to solicit risks from the outside by correspondence and otherwise. As a result of this rate-war, many of the younger companies were brought to the verge of insolvency, and most of the older ones were unable to pay dividends on their capital equal to the current rate of interest. So great was the competition that at the close of 1825 the stock of only four of the twelve stock com-

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[1] For a more detailed account of this early period see "Marine Insurance in the United States," by S. S. Huebner, in *Annals of the American Academy of Political and Social Science*, vol. 26, September, 1905, pp. 252-257.

panies in New York was quoted at or above par. Beginning with 1828, marine-insurance companies were also obliged to pay extraordinary losses occasioned by fraudulent wrecks on the Atlantic, Gulf, and West India coasts. Estimates place the losses incurred in this way at one third of the total loss sustained by companies during the twenty years preceding 1840. It was not until 1844 that the companies of Philadelphia, for example, managed to organize a protective association, through whose action these heavy losses by fraud could be averted.

Beginning with the fifth decade, the business again showed signs of gradual revival, and the twenty years following 1840 may justly be characterized as the "golden epoch" of American marine insurance. It was during these years that the American clipper ship received its highest development, and became the most efficient carrier in the world. Our tonnage in the foreign carrying trade increased from 762,838 registered tons in 1840 to 2,496,894 tons in 1861, the highest point ever reached in our history, and a tonnage nearly two and one half times as large as the largest tonnage registered for any single year prior to 1840. Along with this remarkable increase of 1,734,056 tons in twenty years, American vessels continued during these two decades to carry on an average 70 per cent of the combined imports and exports of the country, the proportion in some years running as high as 81 to 83 per cent. It was also during this epoch that American trade with the Far East and other remote parts of the globe became more prominent than ever before. Unlike the practice in modern commerce, the merchants in those days were largely the owners of the ships which carried their cargoes, and naturally they insured in American companies. The voyages, as a rule, were long, extending in many cases over six or nine months before the vessel was heard from. The risk was thus very considerable, insurance was an indispensable necessity greatly desired, and rates ranged as high

as 5 to 6 per cent. We are told that even between New York and Liverpool the rate on dry goods was as high as 2 per cent compared with the existing rate of between one eighth and one tenth of one per cent on our modern steamers. All these factors—increasing commerce under American ownership, long voyages of a risky nature, and high rates—combined to give to marine insurance during this period an impetus such as it had never experienced before.

But this period of unparalleled growth proved to be only temporary, and was followed by an epoch, extending to the present day, as disastrous to the business as the preceding period had been beneficial. For many years marine insurance had kept in the forefront of our commercial life, and could be ranked with fire insurance in importance. It began to show unmistakable signs of decay when the American flag began to vanish from the sea. This decline has been continuous and unchecked. How severely the business has suffered may be inferred from the fact that since the organization of the first company in New York, in 1796, some thirty companies have been chartered in that state; and of this number only three still continue to do business. To recite the history of the business in other commercial states is merely to repeat its history in New York.

*Reasons for the Decline of the Business.*—Two main causes have contributed toward the decline of American companies, namely, competition from foreign companies and changed business conditions. Owing chiefly to the introduction by England during the fifth and sixth decades of the last century of iron as ship building material and coal as fuel, just at the time when the United States had not yet developed its iron and coal resources, and when the attention of the country was turned away from the sea to the development of the interior, the American wooden ship, which up to this time had been an important factor in international trade, began for the first time to feel seriously the effect of

foreign competition. Immediately following the introduction of the iron steamship by England came the Civil War, with its heavy losses for marine companies, with its heavy taxation of American commerce, with the almost complete cessation of the important cotton trade and trade with the Southern States, with the capture and destruction of Union ships by confederate cruisers, with the transfer by sale of a large portion of American tonnage to foreign countries, and, in general, the complete demoralization of American shipping.

The direct effect of these various factors, growing out of the Civil War, upon our marine insurance companies can scarcely be overemphasized. While the ratio of marine and inland losses paid to premiums received in the United States in recent years amounted to about 50 per cent, that ratio rose to 71.64 per cent in 1865, and to the extraordinary ratio of 83.13 per cent in 1866. Although the premiums in 1866 were increased $3,923,696 over the year 1865, the losses exceeded those of 1865 by $3,938,606. Before business conditions could again become staple, the number of marine insurance companies in New York had been reduced by failures from fourteen (the number in 1861) to nine in 1867, while nearly all that survived were no longer the prosperous companies of the preceding decade.

But there were also indirect effects growing out of the Civil War and the competition of the iron steamship, quite as important as those just mentioned. All the factors enumerated above coming in close succession, and at a most critical time, gave Great Britain the opportunity, which she was only too quick to seize, of monopolizing the construction and operation of the world's shipping. As a consequence, the tonnage of the United States engaged in foreign trade has gradually declined to about one third of what it was in 1861. While the United States carried 75 per cent of our total imports and exports in its own ships during the two

decades from 1840 to 1861, that proportion has steadily declined until to-day it is only about 8 per cent.

Hand in hand with the steady decay of our merchant marine after the war, there followed a corresponding decline in the magnitude and prestige of the marine-insurance business. Great Britain was capturing the carrying trade of the world, and British merchants and shipowners were just as naturally giving their patronage to their own underwriters, just as American merchants and shipowners had insured in American companies while our carrying trade was still in its glory.

But British underwriters were doing more than merely acquiring business which formerly had gone to American companies. They were consciously pursuing a policy which aimed to give preference to their own flag on the sea through inspection and classification at Lloyd's, and through these channels to fix insurance rates. The essential features of this policy may be enumerated as follows:

1. To grade vessels not so much with reference to their design and seagoing capacity as according to their intrinsic quality as measured largely by the cost of construction and repairs. This meant discounting the seagoing worth of the American clipper ship.

2. To favor British-built vessels and British shipbuilding materials in the matter of inspection and classification for shipbuilding purposes.

3. To protect and foster metal and steam tonnage, and to make the British iron steamship, the construction of which was for many years practically monopolized by Great Britain, the standard in international trade. Such a policy was bound to hasten the decline of American shipping. Underclassing the American wooden ship by Lloyd's meant in actual practice a very considerable decrease in the chances for speedy and profitable employment. In 1870, Lloyd's refused to classify and register foreign wooden vessels, except on spe-

cial survey and for a period not exceeding one year. The object was to encourage the chartering of British vessels in preference to wooden ships, and the effect of the rule was to obtain for Great Britain a large part of our carrying trade.

Foreign underwriters, however, were not satisfied with getting the American business that came to them at home, but began in the early seventies to invade American territory itself. In entering American territory foreign companies were materially assisted by the lenient laws of some of our states requiring of foreign companies, as a prerequisite for admission, a deposit equal only to the minimum capital demanded of domestic companies. They began their onslaught by cutting rates; and the American companies, probably too few in number by this time, or otherwise unable to effect an efficient combination in opposition, were compelled to follow suit. Then began a period of the most active competition between domestic and foreign companies, the result of which, in view of the other unfavorable attending circumstances already mentioned, meant the gradual forcing of American companies out of existence.

In this competition the foreign competitors had the advantage of the much better organization and the much greater financial strength acquired at home during their longer existence, and could, therefore, afford to assume much larger risks based on their home capital. The small American companies, on the contrary, though their assets might be considerably in excess of the assets actually held by foreign companies in this country, were, nevertheless, for the reasons mentioned above, limited to a much smaller aggregate of risks. To distinguish between the efficiency of the two classes of companies in this respect one need only examine the data concerning foreign companies, as given in the Insurance Year-Book. Of twenty-seven leading British marine companies mentioned here in 1902, twenty, or three fourths, confine themselves solely to the writing of marine risks;

while in the United States nearly all companies transacting a marine-insurance business placed their greatest reliance upon the fire-insurance branch of their business. Moreover, most of the early American companies have ceased doing business, and only a few of the remaining ones have had a long and continuous existence. In the United Kingdom, on the contrary, of the twenty-seven companies referred to, eight were organized prior to 1837, three considerably before the beginning of the nineteenth century, all except four have had an existence of at least a quarter of a century, and most of them longer. During this long and, on the whole, prosperous existence, these companies have accumulated enormous assets, giving them an advantage over American companies, a fact which becomes clear when we reflect that the eight principal English companies doing business in the United States to-day have assets at home exceeding fifty million dollars. "The financial position of nearly all the British Marine companies," according to the Insurance Supplement to *The Statist*, "is of such strength that even an unusually long period of adversity could be faced with equanimity. By a long process of limiting dividends, they have acquired funds so large that policy-holders are most adequately secured, while at the same time the interest earnings are sufficient, or nearly sufficient, to provide for the maintenance of the present rate of dividends. Thus even very moderate trade profits are amply sufficient to steadily increase the financial security. . . . To show the great and increasing financial strength of the marine-insurance companies, it should be noted that the accumulated funds have increased 38 per cent during the decade 1893 to 1903, the premium income has only risen 14 per cent, and the proportion of the former to the latter has risen from 177 to 217 per cent. Thus the invested funds represent over £2 for every £1 annually received from policy-holders, an exceedingly satisfactory position from all points of view. . . . In fact, the financial position of most of the offices is

so strong that temporary profit fluctuations may be disregarded, and in many cases present dividends could be maintained even if the companies undertook no more business whatever.'' English companies are to-day our main competitors, but companies of other countries, notably German and Canadian, are entering the ranks against us. Even on the Pacific coast some nineteen foreign companies are doing business, representing England, Germany, France, Italy, Switzerland, China, and Japan.

*The American Business of Domestic and Foreign Companies Compared.*—The extent to which foreign companies have acquired control of marine insurance in the United States becomes clear if one examines the annual financial reports of the various companies. A few years ago the author made a compilation of the statistics found in these reports for the year 1903; and, since conditions have not changed materially, the results are here presented. This study showed that the total net marine risks assumed by all foreign and domestic companies operating in the United States aggregated approximately $6,877,000,000. The net premiums were nearly $18,000,000, and the admitted assets $112,912,000. Of these amounts the American branches of the twenty leading foreign companies (to say nothing of the large number of foreign companies operating on the Pacific coast) wrote $3,723,000,000 of the risks, or 54 per cent of the total, received $7,160,335 of net premiums, but possessed only $21,733,958, or less than one quarter of the estimated assets. Most of these foreign companies also confine themselves solely to the writing of marine risks, only six of the above twenty companies transacting a fire business in addition to their marine business.

Unlike the foreign companies operating in the United States, the domestic companies depend much more largely on a fire-insurance business carried on in conjunction with their marine business. Only five of the thirty-one domestic

companies in 1903 devoted themselves exclusively to marine insurance, and of these five companies only two could be classed as important. All the other companies combined a fire-insurance business with the marine business, and almost without exception placed much greater emphasis upon the former than upon the latter. Combining the business of all the domestic marine and fire-marine companies, it appears that they carry nearly three times as much fire risk as marine and inland risks, and receive nearly four times as much in premiums from their fire as from their marine and inland business. Moreover, upon inquiry it was learned from a considerable number of companies that their marine business has been and is decreasing in volume, owing to the fact that large foreign marine companies insure entire ship cargoes, leaving only small amounts to be picked up by the smaller companies. Other companies continue to carry each year a small amount of insurance of from several hundred to a few thousand dollars in premiums, for the sole purpose of keeping alive that part of their charter which permits them to write marine insurance.

It appears furthermore that the business of the foreign companies operating in the United States is by no means limited to any particular section of the country. Domestic companies seem entirely unable to meet American requirements. On the Eastern coast foreign companies claim nearly one half of the business. The same is true to an even greater extent in the Lake region; while in the Gulf states and on the Pacific coast approximately four fifths of the business is controlled by foreign capital. Even in our coastwise trade, the one branch of our commerce from which foreigners have been excluded by statute for nearly a century, the largest buyers of insurance place it almost half and half between domestic and foreign companies. Evidence before the United States Industrial Commission shows that the home market soon becomes exhausted, and that it is the

practice of the principal shipping companies to take all the American insurance they can obtain, and to depend upon foreign underwriters for the rest.

Recently there has also been a marked tendency toward self-insurance. The International Mercantile Marine Company, for example, embracing some of the largest steamship lines leaving the port of New York, announced in its report of December 31, 1903, that "the company has inaugurated a system of insuring its own ships to a large extent, it being deemed that this could be done advantageously and safely with such a large fleet as the company commands" (138 ships).

While this is the most notable recent example of self-insurance, it should be remembered that this method was practiced on a large scale many years ago. As early as 1867 we are informed by Mr. Hopkins, in his work on Marine Insurance of that date, that the Peninsular and Oriental Steamship Company possessed not only an insurance system for its fifty-three large steamships, but also insured its passengers, baggage, and effects, and issued policies on goods. Information from the managers and officers of the largest steamship lines shows that self-insurance is practiced extensively by their companies in one form or another. While the coastwise lines and the smaller transoceanic lines depend almost entirely upon marine-insurance companies for their insurance, it appears that in the case of such lines as the great German steamship companies, nearly all the insurance is carried by the companies themselves. It is the general rule, however, followed by the German lines as well as the International Mercantile Marine Company, that they refrain from insuring the cargo, and permit this risk to be covered by marine-insurance companies.

# CHAPTER XXIII

## THE ORGANIZATION AND PURPOSES OF LLOYD'S

THE great importance of Lloyd's in marine insurance from an international standpoint justifies an explanation of its organization and purposes. Until 1871, Lloyd's was an unincorporated body where underwriters assembled and transacted business at will, subject to few regulations. In the year 1871, however, Lloyd's became an incorporated body; and, according to the act of incorporation, exists for the threefold purpose of conducting an insurance business, of protecting the commercial and maritime interests of its members, and of collecting and disseminating information pertaining to shipping.

To obtain a clear view of how this threefold purpose is realized it is essential to study the institution of Lloyd's from two points of view, namely, the Intelligence Department and the Corporation of Underwriters. For the sake of convenience we may consider the Intelligence Department first, since the collection and diffusion of maritime information is a prime prerequisite to successful underwriting. Briefly described, this department consists of numerous agents situated in nearly every part of the world, whose position is considered one of honor, and whose duty it is to promptly forward information to headquarters concerning the arrival and departure of vessels, the occurrence of wrecks and accidents, or any other events which vitally affect shipping. As representatives of Lloyd's, these agents are also required to render aid to masters of vessels in distress, to take charge of a wrecked vessel's stores and materials in

order to avoid unnecessary loss, to adopt precautionary measures against dishonesty when it becomes necessary to repair ships, and, in a general way, to protect the interests of the marine underwriters. To supplement the efforts of these agents, Lloyd's also desires the masters of vessels to report to the nearest Lloyd's agent any information of interest concerning other ships which they may have seen or spoken with while on their voyage.

All the information thus obtained by Lloyd's from agents and shipmasters from all parts of the globe is then analyzed and distributed for the benefit of underwriters and subscribers. This brings us to the next important feature of Lloyd's, namely, the publications. These are five in number, namely:

1. *Lloyd's List.*—The official daily publication of the corporation containing all shipping news as currently received, and generally recognized as the most reliable among the various sources of maritime intelligence.

2. *Lloyd's Register of British and Foreign Shipping.*—An annual publication, founded in 1834, and designed to indicate the general character of all vessels in the British Marine of not less than one hundred tons, besides numerous vessels in foreign fleets. Among other items this publication states the name, materials of construction, and state of repairs of the ship, its dimensions, registered tonnage, and general equipment, the date and place of construction and by whom constructed, the name of the owners, the port to which the vessel belongs, the date of the last survey, and, finally, the name of the master, and the date of his appointment. To keep the shipping world informed of any variation which may occur, supplementary lists are published monthly in connection with the annual edition of the Register. In other words, this annual Register may be likened to a catalogue of nearly all the important vessels of the world, from which the underwriter may ascertain, by a hurried refer-

ence, the general fitness of a specified vessel to make a given voyage or carry a certain cargo. To render such reference on the part of the underwriter still easier, both iron and wooden vessels are divided into separate classes, and these classes into grades, each grade being designated by a conventional symbol.

Lloyd's Register is thus the handbook of the underwriter; but it should always be kept in mind that while it is of the greatest service to those who accept marine risks, it is controlled by authorities of its own, and is an institution entirely distinct in organization from the corporation of underwriters. Since the classification of vessels is fundamental in the shipping and insurance business, the importance of a publication like Lloyd's Register cannot well be overestimated. Its influence became so potent a factor in British shipping that other nations were obliged to adopt a similar system; until to-day Lloyd's Register constitutes the standard after which other maritime nations have modeled their own Registers. To such an extent has the classification of vessels become a necessary adjunct to the shipping industry that practically no vessel of importance in any nation is without a regular classification in some standard register. Chief among the registers now published in addition to Lloyd's are the Register of American Shipping and the American Lloyds of the United States, the Bureau Veritas of France, the Germanische Lloyd, and the Stettiner Register of Germany, the Austro-Ungarian Veritas of Austria, the Nederlandische-Wereinigung of Holland, the Norske Veritas of Scandinavia, and the Veritus Hellenique of Greece.[1]

[1] In the modern system of classification, as Professor Gambaro explains, "Ships are divided into three classes, according to the degree of confidence to be placed in their seaworthiness. A vessel recently and strongly built, well-rigged and equipped, is assigned for a number of years to the first class, and may, therefore, during such period, be employed with full confidence in any voyage for

3. *The Index.*—A list of all British mercantile vessels, together with numerous foreign ships showing their condition and location according to the latest reports. This publication is not only open to inspection at Lloyd's, but members and subscribers, wherever situated, may, upon request, obtain the latest news concerning any particular vessel.

4. *A Register of Captains.*—A biographical dictionary containing a record of the service, proficiency, and character of the twenty-five thousand or more certified commanders of the British marine, and

5. *A Record of Losses.*—Frequently called the "Black Book."

Turning now to the corporation of Underwriters as distinct from the Intelligence Department, it must be noted that its membership consists of two classes: (1) The underwriting members who write insurance for their own profit, subject, of course, to the rules and requirements imposed by the managing committee of Lloyd's, and (2) the non-underwriting members, who, as brokers and merchants, transact business with the underwriting members, either for themselves or others. In addition to these two classes there are also numerous subscribers to Lloyd's for the information

the conveyance of any kind of merchandise; provided, of course, that she suffer no deterioration or damage such as may render her unserviceable, and be maintained in good state of repair, which is ascertained by periodical surveys. A second term of the same class is often granted to ships proving still strong and in a good state of preservation after the first period. A special distinction over and above the highest classification may be obtained for a ship provided such materials be used in her build as directed by the committee. Vessels which have gone through this first class term are assigned to the second, and, lastly, to the third class, the latter embracing vessels in very poor condition, considered fit only for short and easy voyages and to carry cargoes not to be damaged by sea water, such as timber, salt, etc."—Gambaro's "Lessons in Commerce," p. 137.

received at the Royal Exchange, many of whom are British and foreign insurance companies. Nearly all the great marine-insurance companies of the United Kingdom, even though their marine business in the aggregate far exceeds that of Lloyd's, are nevertheless represented on its floor, and necessarily and continually receive the assistance of that organization in the prosecution of their business.

As a corporation Lloyd's resembles our stock exchanges in many particulars. It assumes no responsibility whatever for the solvency of its members. It seeks only to provide proper facilities to its members for the conduct of their business, and to limit admission to men of recognized honesty and financial standing. As a guarantee for the fulfilment of contracts, each underwriting member is required to deposit with the committee of Lloyd's securities to the value of £5,000. Aside from this requirement the corporation does not concern itself as to the nature or the volume of the business transacted by its members. They are free to do as much underwriting as they like, and may pursue any kind of insurance they choose, only they must act honestly. As a consequence, Lloyd's, although marine insurance and the furnishing of maritime intelligence is the fundamental character of its business, is a place where one may insure against a large variety of contingencies—fire, epidemics, sickness, and all sorts of accidents, against the risks of journeys and business ventures, against the loss of works of art and valuable possessions, or against loss in gate receipts from the unforeseen stoppage of games and races, or to meet contemplated changes in foreign tariffs, or to provide against the risks of war during periods of political excitements, and a hundred and one other contingencies of every conceivable kind. Combining all these different forms of indemnity with the marine business, authorities place the total amount of risks carried at Lloyd's at approximately $3,000,000,000, while the total deposits paid in by members as a guarantee

for the performance of contracts are placed at not more than about one per cent of the risks assumed.

In its daily routine of business Lloyd's affords an interesting and instructive spectacle, and illustrates the arbitrary character of a good share of the business. On the Exchange, for example, are several hundred underwriters unincorporated, and unable thus to act jointly. To describe the manner in which these members transact business, we cannot do better than cite from Mr. Samuel Plimsoll's concise and picturesque account:

"There are seldom less than fifty underwriters on a policy, frequently over one hundred (the three policies before me show an average of seventy-two subscribers), not bound together at all, each individual can act only for himself, and accepts just so much of the whole risk as he pleases. He seldom, almost never, accepts for any large amounts, always for a very small proportion indeed of the whole amount covered. The way of it is this: A member of Lloyd's (underwriters' room) first gives evidence or security as to his ability to pay losses; then he has a desk allotted to him (they are very numerous—between three hundred and fifty and four hundred in London alone, where, however, the bulk of underwriting is done); the proposals of insurance are handed around by the insurance brokers' clerks all day long. These proposals, called slips, give the name of the ship, amount to be insured, and rate per cent offered. Perhaps sixty or seventy of these slips, or even more, are laid before each underwriter daily. After reference to Lloyd's List of Ships, he either passes it on or, if he decides to 'take a line' upon it, he subscribes or 'underwrites' his name, together with the amount he is willing to guarantee for at the rate specified. This varies much, and generally goes as low as £200 or £100, frequently £50, and sometimes even less than that—never an amount large enough to warrant his disputing his liability in case of loss." [1]

As a result of the procedure thus described by Mr. Plimsoll, it follows that the underwriter at Lloyd's has practically no opportunity to examine the risk as he would do in other

[1] Samuel Plimsoll, The Nineteenth Century, Vol. XXV, p. 329.

leading forms of insurance. The sources of information which he might use as a guide are, as a rule, the publications of the corporation like the Annual Register, the Captain's Register, and Lloyd's List. From these he may obtain useful information concerning the age, size, structure, equipment, and management of the vessel as based on frequent surveys by expert surveyors. But, naturally, such classifications have their limit, and do not purpose giving more than a general description of the vessel in question. Concerning many factors relating to stowage, the amount of load, the size and efficiency of the crew, and numerous other factors, equally vital to the safety of the vessel and cargo at sea, these publications can offer no assistance. It is here that the insurer must use his judgment, and success is largely dependent upon the specialized ability of the underwriter. Nor would it be to the interest of the insurer at Lloyd's to make such an examination, assuming that he could do so. Not only will his limited time and the large number of proposals made to him daily render this impossible, but the mere fact that probably half a hundred other persons have underwritten the same policy will make it seem foolhardy that he alone should undertake the examination. To retain his business he must be quick in accepting or rejecting proposals on the spot, and cannot afford to tarry, since it is the broker's business to secure insurance for his patrons as quickly as possible. Moreover, the amount of the total risk to which he has subscribed is, as we have seen, comparatively small, and limited to an amount which will not make it worth his while to contest a claim or pursue an examination.

Even if the underwriter be a subscriber for a large amount, it does not necessarily follow that he will be actually liable for the amount underwritten, for as soon as he fears that he has sustained a loss he will endeavor to transfer his risk. This he does by offering a higher premium as an inducement for some one else to take all or a share of his risk.

One underwriter fearing a loss thus transfers part of his risk to another, who expects the early and safe arrival of the vessel. If uncertainty concerning the vessel continues, this second underwriter, by offering a still higher premium, may transfer part of his risk to another, who again has good hopes, and so on until, if it is finally learned that the vessel and cargo are lost, the risk has been so widely diffused that the loss incurred by any one individual is comparatively small. Lastly, it is interesting to note that collectively the underwriters at Lloyd's have no interest in examining risks, because they have no interest in diminishing loss. On the contrary, strange as it may seem, they express a preference for a high rate of loss to a low one. Individually, they all desire and expect to avoid the payment of claims, but collectively they all wish and expect to profit by high rates. Hence it is that they prefer the increase in premium which accompanies an increase in losses.

## COPY OF LLOYD'S FORM OF POLICY

S. G.

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Be it known that .................. as well in .... own name as for and in the name of all and every other person or persons to whom the same doth, may, or shall appertain, in part or in all, doth make assurance and cause ...................... and them and every of them to be insured, lost or not lost, at and from ..................... ...................... upon any kinds of goods and merchandises and also upon the body, tackle, apparel, ordnance, munition, artillery, boat, and other furniture, of and in the good ship or vessel called the ..............., whereof ........................ is master, under God for this present voyage, ..............., or whosoever else shall go for Master in the said ship or by whatsoever other name or names the same ship, or the Master thereof, is or shall be named or called, beginning the adventure upon the said goods and merchandises from the loading thereof aboard the said ship, upon the said ship, her tackle, apparel, etc., .............., and shall so continue and endure, during her abode there, upon the said ship, etc.; and further until the said ship, with all her ordnance, tackle, apparel, etc., and goods and merchandises whatso-

ever, shall be arrived at port of discharge as above and upon the said ship, etc., until she hath moored at anchor twenty four hours in good safety, and upon the goods and merchandises until the same be there discharged and safely landed; and it shall be lawful for the said ship, etc., in this voyage to proceed and sail to, and touch and stay at any port or place whatsoever, .................. ........ without prejudice to this Insurance. The said ship, her tackle, apparel, etc., goods and merchandise, etc., for so much as concerns the assured, by agreement between the assured and assurers in this Policy, are and shall be valued at .................

Touching the adventures and perils which we, the Assurers, are contented to bear and do take upon us in this voyage, they are: of the seas, men-of-war, fire, enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, surprisal, taking at sea, arrests, restraints, and detainments of all Kings, Princes, and People, of what nation, condition or quality soever: barratry of the Master and Mariners, and of all perils, losses, and misfortunes, that have or shall come to the hurt, detriment, or damage of the said goods and merchandises and ship, tackle, apparel, etc., or any part thereof; and in case of any loss or misfortune, it shall be lawful to the Assured, their factors, servants, and assigns, to sue, labor, and travel for, in and about the defence, safeguard, and recovery of the said goods and merchandises and ship, etc., or any part thereof, without prejudice to this Insurance; to the charges whereof we, the Assurers, will contribute each one according to the rate and quantity of his sum herein assured. And it is agreed by us, the Insurers, that this Writing or Policy of Assurance shall be of as much force and effect as the surest Writing or Policy of Assurance heretofore made in Lombard Street, or in the Royal Exchange, or elsewhere in London. And so we, the Assurers, are contented, and do hereby promise and bind ourselves, each one for his own part, our heirs, executors, and goods, to the Assured, their executors, administrators, and assigns, for the true performance of the premises, confessing ourselves paid the consideration due unto us for this Assurance by the Assured ...........at and after the rate of .... per cent.

In Witness whereof we, the Assurers, have subscribed our names and sums assured in London, ................, 191...

N. B.—Corn, fish, salt, fruit, flour, and seed are warranted free from Average, unless general, or the ship be stranded; sugar, tobacco, hemp, flax, hides, and skins are warranted free from

Average under Five Pounds per cent; and all other goods, also the ship and freight, are warranted free from Average under Three Pounds per cent, unless general, or the ship be stranded.

(Here may follow various attachments to the policy.)

[At top on left.]

This policy is issued in the form printed and supplied by the Government previous to 1st August, 1887 (with ........, additions printed in italics).

For signature by underwriting members of Lloyd's only. (34 & 35 Vic. Anchor. Lloyd's act, 1871.)

Any person not an underwriting member of Lloyd's subscribing this policy, or any person uttering the same if so subscribed, will be liable to be proceeded against under sec. 31 of Lloyd's act.

[Space for signatures of underwriters.]

£700 [11 names; "one twelfth" opposite 10 names, "tw twelfths" opposite 1 name], of seven hdd. pds. per (name).

£50 [1 name], fifty pds.

£600 [21 names], each one twenty first part of six hundred pounds per (name).

£500 [21 names], each one twenty-first part of five hdd. pds. per (name).

£500 [12 names], each one twelfth part, five hdd. pds. per (name).

£50 [1 name]<br>
£50 [1 name] } fifty pounds per (name).<br>
£50 [1 name]

£100 [5 names], each one fifth of one hdd. pds. per (name).

£150 [9 names], each one ninth part of one hdd. & fifty pds. per (name).

£150 [5 names; "two sevenths" opposite 2 names, "one seventh" opposite 3 names], of one hdd. & fifty pds. per (name).

£50 [1 name] } fifty pds., each per (name).<br>
£50 [1 name]

£20 [1 name], twenty pds. per (name).

£500, underwriting members of Lloyd's [20 names], each one twentieth part, five hundred pds. per (name).

# CHAPTER XXIV

## TYPES OF POLICY CONTRACTS IN MARINE INSURANCE

A CONTRACT of marine insurance has been defined as "a contract of indemnity, in which the insurer, in consideration of the payment of a certain premium, agrees to make good to the assured all losses, not exceeding a certain amount, that may happen to the subject insured, from the risks enumerated or implied in the policy, during a certain voyage or period of time."[1] It is essential in a marine policy that the parties to the contract shall have undertaken the transaction in good faith. This is true of all contracts, but especially so of a contract of marine insurance, where the risks assumed are not only very numerous, but also very complex. Moreover, all material facts must be stated to the underwriter, and fraud of any kind will nullify the policy. The misrepresentation or concealment of material facts with a view, for example, to deceive or influence an underwriter into accepting a risk or in fixing the premium will deprive the offending party not only of any premiums paid, but of all rights accruing from the policy.

Equally essential to the validity of a marine-insurance policy is the requirement that the insured shall actually possess an insurable interest in the subject insured. Such an interest, however, need not necessarily represent ownership. As Mr. Justice Lawrence defined it: "To be interested in the preservation of a thing is to be so circumstanced with respect

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[1] John Duer, "Law and Practice of Marine Insurance," Vol. I, p. 58.

to it as to have benefit from its existence, prejudice from its destruction. The property of the thing and the interest derived may be very different. Of the first, the price is generally the measure; but, by interest in a thing, every benefit and advantage *arising out of or depending on such thing* may be considered as being comprehended." [1] This definition indicates that any one pecuniarily interested in the safe arrival of a vessel or cargo has an insurable interest in the same. A mortgagee has an interest in a vessel to the extent of his mortgage, which he may insure. A trustee or bailee possesses an insurable interest in property entrusted to him, as also does a consignee of goods who has advanced money against their value. Advances made for repairs to a ship at a port of refuge, which are to be repaid at the close of the voyage out of the ship's cargo and freight, give rise to an insurable interest. Those concerned in any profits to be derived from a venture have an insurable interest in them; and among the numerous other ways, besides ownership, in which an insurable interest may exist in a given subject, it is almost needless to state, is the interest which the marine underwriter himself possesses in the risks he has underwritten, and which he very frequently finds it desirable to reinsure.

Summarizing, then, the essential features of a marine-insurance policy (following Mr. Gow's outline), it may be described as:

"(1) A contract of indemnity;
(2) Made in good faith (in uberrima fide);
(3) Referring to a defined proportion;
(4) Of a genuine interest in a named object;
(5) Being against contingencies definitely expressed, to which that object is actually exposed;
(6) And in return for a fixed and determined consideration." [2]

[1] William Gow, "Marine Insurance," Second Edition, p. 77.
[2] Ibid., p. 11.

An examination of the various types of marine policies in use in the United States shows that numerous titles are employed to designate them according to the subject matter insured. Thus among the various types of policies issued by American companies there are so-called "vessel policies," "vessel and freight policies," "cargo policies," "steamboat policies only," "tug policies," "stranding or collision policies only," "lighterage policies," "yacht policies," "whaling and fishing policies," "canal hull policies," "river cargo policies," "lake cargo and vessel policies," "cotton policies," "builders' policies," etc. While a comparison of these numerous policies in different companies shows that scarcely two are exactly alike, yet a closer examination, whether we regard vessel, cargo, or freight policies, will show that they have all been adapted to the particular risk from a common form, and that, despite variations, the printed form of the contract is approximately the same as regards essential particulars. The only real difference exists in the adaptation of the contract to meet certain particular conditions, and not in the essential form or content of the document itself.

As special circumstances may render one form of policy more desirable than another, marine policies may also be conveniently grouped into four classes, according to the nature of the risk assumed, or the manner in which the policy is executed. Briefly stated, this fourfold classification depends, first, upon the manner in which the value of the subject matter of the insurance is expressed in the policy; second, upon the absence or presence in the policy of the name of the vessel which is to make the voyage; third, upon the period of time during which the risk is covered; and, fourth, upon the interest of the policy-holder in the subject insured.

Under the first classification the policy may be either "valued" or "open"; a valued policy being one which stipulates some agreed value (not necessarily the real value), such

as $1,000 worth of goods, or a ship worth $50,000; an open policy, on the contrary, being one which omits to specify the value of the subject insured, but leaves this to be ascertained when a loss occurs. The important difference between the two is that in case of total loss, in the absence of fraud, the valued policy entitles the insured to receive the value specified in the policy without proving the loss, while the open policy makes necessary an adjustment as proof of the loss incurred. In case of partial loss, however, this difference does not exist, since the same adjustment must be made, irrespective of whether the policy is open or valued.

Similar to the two types of policies just named is the second classification, namely, that referring to the presence or absence in the policy of the name of the vessel for a particular voyage. Under this classification policies may be either "floating" or "named." By a floating policy is meant one which describes the limits of the voyage, the value of the property insured, and the type or class of vessel to be employed, but does not specify any particular vessel. The policy, in other words, is stated to apply to any "ship or ships." The wording is thus made sufficiently broad to enable a merchant to insure his goods before ascertaining the name of the vessel on which they will be shipped, and to give him protection in case of loss, before he is able to make a specific insurance. As soon, however, as the name of the vessel employed on the voyage becomes known to the insured, this information, together with any important attending facts, is "declared" to the underwriter and "indorsed" on the policy, thus making it a "named" policy instead of a "floating" one.

Under the third group there may be either "voyage" or "time" policies, the first denoting insurance for a specified voyage, as from New York to Liverpool, and the second referring to insurance for a period of time, usually one year. Lastly, we may have what is called an "interest" policy, or

one clearly indicating that the insured possesses a true and substantial interest in the subject matter of the insurance, such as one hundred bales of cotton or a thousand bushels of wheat. In contrast to this type of policy is the "wager" policy, which, as its name implies, clearly shows that the holder has no insurable interest in the property covered by the policy, or that the underwriter, at least, will not demand proof of the same. One of the cardinal principles of insurance law is that an insurance policy, to be valid, must represent an insurable interest on the part of the insured. Hence in a wager policy it is customary to insert such expressions as, "interest or no interest," "policy proof of interest," and the like, which signify that by common agreement between underwriter and insured, the latter is entitled to the payment provided in the policy upon the loss of the subject insured, irrespective of the fact that he has no strictly insurable interest in the same. Owing, however, to the universal observance of the principle of insurable interest, it would be very difficult to collect on such a policy in any American court. In England, where such policies have been declared void by statute, they still continue to exist to a limited extent; their fulfilment, however, resting on the basis of so-called "honor" agreements.

Marine insurance, as already noted, in connection with the discussion of Lloyd's policy, has had a development of several centuries. Though introduced several hundred years ago, Lloyd's policy still furnishes illustrations of the quaint language of earlier days, and affords a just basis for the characterization, often made, that it is an "incoherent and antiquated instrument." But whatever may be said against the policy, because of its poor adaptation to the needs of modern commerce, is largely counterbalanced by the advantage of the certainty in meaning and the stability in marine transactions, which become possible through the use of a policy which has back of it several centuries of legal deci-

sions, and which has acquired a more and more definite meaning, until, to-day, nearly every word it contains has been interpreted by the courts. It is this desire to have a definite and interpreted contract as the basis of marine-insurance transactions which has been largely responsible for the fact that numerous features of Lloyd's policy have been incorporated and retained in American policies to this day. Many important changes have been introduced into American policies as compared with the Lloyd's form, yet in some important particulars, like the enumeration of the perils against which insurance is taken, the influence of Lloyd's is still clearly apparent.

## FORM OF APPLICATION FOR MARINE INSURANCE

### COASTWISE APPLICATION

Insurance is wanted by .......................... Company, of .............., for account of whom it may concern, loss, if any, payable in funds current in the United States or in the city of New York to the said company or order.

It is understood and agreed that this insurance is to cover the liability assumed by the ...................... Company with respect to merchandise transported by it which the assured or any of their agents or any of their railroad or other connections may have agreed or may agree, whether by written agreements, arrangements, or understandings, or otherwise, with owners, shippers, consignees, or others interested in or connected with said merchandise, to insure touching the adventures and perils specified in the body of the policy.

To attach from the time that the merchandise is receipted for or in the custody of the assured company and to continue until the delivery of the merchandise to consignees or connecting carriers, including lighterage and transshipment, but neither at the port of loading nor port of destination is the risk of fire to exceed five days before loading or after discharge.

Each shipment or interest and/or each kind of goods therein, subject to separate particular average as if separately insured.

It is also understood and agreed that the liability of the assured

as common carriers, as to interests insured hereunder, is covered in conformity with the printed conditions of this policy.

Goods on deck warranted by the assured free from loss by wet, leakage, breakage, or exposure.

Proof of loss to be authenticated by the agent of the company, if there be one, at the place such proofs are taken.

Warranted by the assured free from claim on account of capture, seizure, detention, or destruction, by or arising from hostile forces, civil commotions, riots, or by the acts of officers or other persons acting in the name of belligerents, or in pursuing warlike operations whether before or after declaration of war.

# CHAPTER XXV

## THE NATURE OF THE RISK ASSUMED AND THE PERILS INSURED AGAINST

THE general description of the subject matter insured and the character and duration of the voyage are usually set forth in the opening words of the policy. No uniform wording has been adopted by all the companies in this respect, yet as representative of the conditions usually provided, the following form is given as typical of American vessel policies:

BY THE ........................ Insurance Company .......... ........, on account of ........................, in case of loss, to be paid to ........................ Do.. make insurance, and cause.. to be insured, lost or not lost, at and from the ........ day of ........, 191.., at noon, until the ........ day of ........, 191.., noon. If on a passage at the expiration of the term, with liberty to renew the policy, for one, two, or three months, at the same rate of premium, if application be made to the company on or before the expiration of the first term. The risk, however, is to terminate at any port at which she may first arrive during the said extended time, on her being moored therein twenty four hours in good safety; a pro rata premium to be returned for each entire month not entered of the extended time, there being no loss or other claims made. (Then may follow certain warranties and agreements.)

.................... upon the body, tackle, apparel, and other furniture of the good ...... called the ........ whereof is master for this present voyage ...................., or whoever else shall go for master in the said vessel, or by whatever other name, or names, the said vessel, or the master thereof, is or shall be named or called.

And it shall and may be lawful for the said vessel in her voyage to proceed and sail to, touch, and stay at any ports or places,

**if thereunto obliged by stress of weather or other unavoidable accident, without prejudice to this insurance. The said vessel, tackle, etc., hereby insured, are valued at ...................... without any further account to be given by the assured to the assurers, or any of them, for the same.**

In the case of cargo and freight policies, while the form is similar to that mentioned above, the following provision is usually made with reference to the beginning and termination of the risk: "Beginning the adventure upon the said goods and merchandise as aforesaid, from and immediately following the loading thereof on board the said vessel and to continue during the voyage aforesaid, until the property is landed."

The first features to attract attention in the above extract of the policy are the two expressions, "lost or not lost" and "at and from." Both were introduced very early into marine policies, and both serve a distinct purpose. The object of the first phrase originally was to provide for those cases where the safety of the vessel was feared because of its having long been overdue and unheard from (a very common occurrence before the introduction of steam power, the telegraph, and modern postal communication), and where insurance is, therefore, especially desired. Such cases occur even to-day, and it also frequently happens that the owner of goods may have them exposed to the perils covered by a marine policy before he knows of their having been shipped, or before he has had opportunity to insure them. The real object of the phrase is to have the policy cover a risk irrespective of the condition or position in which the ship or cargo may be at the time when the insurance is effected. To make the contract valid, however, both insured and underwriter must be in possession of the same facts, and neither must have knowledge concerning the condition of the risk.

In explanation of the second phrase, "at and from," it is important to note that there is a decided difference be-

tween insuring a ship and cargo "from" a port and insuring it "at and from" that port. The first insurance would cover a vessel, for example, only from the moment when it departs on her voyage, while the "at and from" insurance would cover the vessel not only while on the voyage, but also at the port of departure before leaving. In case this is the home port, the insurance takes effect as soon as placed, and protects the vessel during the period of preparation for the voyage. In case the port is one at which the vessel has not yet arrived, the insurance commences with the arrival of the vessel at that port, if in safe condition.

Following the phrases just noted, there are blank spaces for the insertion of the voyage, the period of time over which the insurance extends, the name of the vessel, and the general description and valuation of the subject matter insured. The presumption is that the voyage will cover the usual route, and will be prosecuted without delay. If the policy is a time policy, the date and hour when the insurance commences and ends must be specifically stated. In the case of goods and merchandise, it is expressly provided that the policy covers immediately after they are loaded on board the vessel and continues during the voyage until safely landed. But where it is necessary to employ lighters in the process of loading, the risk of lighterage, except where otherwise provided, is also covered. In the case of a vessel, the insurance either commences "from" or "at and from" a port, and ends twenty-four hours after the arrival and safe mooring of the same, at the port of destination. With respect to freight (the earnings of the ship for conveying the cargo), the insurance covers from the port of loading to the time when the cargo is safely landed; while in the case of a charter the insurance begins when it is effected, and continues, irrespective of the fact that the vessel must load at another port, until the landing of the cargo.

With respect to the valuation of the subject matter in-

sured two cases may arise. First, where the value is agreed upon, it cannot be reconsidered unless a clearly proved mistake has been made, or the relation of the assigned value to the real value is such as to afford just grounds for suspecting the existence of fraud or wagering. Where, however, the value is not stated in the policy, as in open and floating policies, it must be proved. In all such cases the insurable value attaching to various interests is ascertained in England and America on the following basis, subject, of course, to any provisions expressed in the policy:

(a) Goods or merchandise: the prime cost (say invoice cost) plus shipping expense and cost of insurance.

(b) Ship: the value at the commencement of the voyage, including the outfit, stores, and provisions for crew, advances made against crew's wages, and cost of insurance.

(c) Freight: the gross freight due to the ship on her arrival abroad plus cost of insurance.

(d) Other objects of insurance: the value to the assured at the commencement of the voyage plus cost of insurance.[1]

*The Perils Against Which Protection is Granted.*—Immediately following the general description of the adventure, the marine-insurance policy specifies the perils against which protection is granted. In the policies of a few American companies, the enumeration corresponds exactly with the quaint enumeration in the Lloyds' policy, namely:

"Touching the adventures and perils which the said........... ........... Insurance Company is contented to bear, they are of the seas, men-of-war, fires, enemies, pirates, rovers, thieves, jettisons, letters of mart and countermart, reprisals, takings at sea, arrests, restraints, and detainment of all kings, princes, or people of what nation, condition, or quality soever, barratry of the master and mariners, and all other perils, losses, and misfortunes that have or shall come to the hurt, detriment, or damage of the said vessel (or goods) or any part thereof."

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[1] William Gow, "Marine Insurance," p. 67.

Most American policies, however, while retaining the language of the above clause in other respects, omit the specifications of all perils except those of the sea, fire, and barratry, and assume liability for all losses "to which the insurers are liable by the rules and customs of insurance in (*name of port*), subject to the conditions and provisions contained or referred to by clauses in this policy." In the case of some companies, especially those insuring inland risks, the policy grants protection against the perils of the lakes, rivers, canals, railroads, and all other losses or misfortunes except those arising from carelessness or lack of skill in loading or stowing the cargo, or in navigating the vessel, or from other legally excluded causes.

A closer examination of the marine perils against which insurance is granted shows that they may be divided into four main classes, viz.: (1) Those perils which have been appropriately called the "perils of nature," such as the "perils of the sea" and fire; (2) those enumerated perils which we associate with the conduct of those aboard the vessel, as jettison and barratry; (3) perils arising from the conduct of those not aboard the vessel, such as enemies, pirates, men-of-war, etc.; and lastly (4) those perils referred to in the terminal clause, including "all other perils, losses, and misfortunes that have or shall come to the hurt, detriment, or damage of the vessel or cargo."

Of these perils many are self-explanatory, and require no comment. Many, though very important at one time, when travel was slow and dangerous and commerce subject to piracy and privateering, have become relatively unimportant to-day, owing to the introduction of the telegraph, modern postal communication, and the numerous other changes which have completely revolutionized commercial facilities and methods. Four of the perils mentioned, however, may require a few words of explanation, namely, the "perils of the sea," fire, jettison, and barratry.

The "perils of the sea" do not include all casualties that may happen to a ship or cargo on the sea. Not only must the loss be incurred in consequence of some peril which is of the sea, but, even where this is the case, it must be the result of an unforeseen occurrence, i.e., an accident. It must not be in consequence of occurrences which are inevitable in all navigation, such as the wear and tear produced by the wind and waves, or the inherent defects and natural deterioration of certain classes of articles. According to Phillips the term "perils of the sea" comprehends those of the winds, waves, lightning, rocks, shoals, collision, and, in general, all causes of loss and damage to the property insured, arising from the elements and inevitable accidents.[1] Likewise in the case of fire, the underwriter is liable for all losses arising from it, provided only that the cause was accidental and not brought about by any action of the insured for which he is considered responsible. Among the many causes of fire covered by the policy are lightning, spontaneous combustion, and the damaged state of the cargo.

Jettison consists of "the throwing overboard of a part of the cargo, or any article on board the ship, or the cutting and casting away of masts, spars, rigging, sails, or other furniture for the purpose of lightening or relieving the ship in case of emergency."[2] This definition does not cover those cases where goods are jettisoned because of natural deterioration or inherent defects. Nor does it cover jettison of property due to the negligence or default of the owner; nor of deck cargo, except where expressly permitted in the policy.

Barratry, on the other hand, "comprehends not only every species of fraud and knavery covinously committed by the master with the intention of benefiting himself at the

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[1] Willard Phillips, "A Treatise on the Law of Insurance," Vol. I, p. 635.

[2] Frederick Templeman, "Marine Insurance: Its Principles and Practice," p. 33.

expense of his owners, but every wilful act on his part of known illegality, gross malversation, or criminal negligence, by whatever motive induced, whereby the owners or the charterers of the ship are, in fact, damnified."[1] As coming under barratrous acts may be mentioned the scuttling of a ship, wilfully destroying or injuring a ship by running it ashore, setting it on fire, or abandoning it, or selling a vessel or deviating it from the true course of travel with the object of obtaining gain in some way. To constitute barratry, however, it is essential that these acts should be done against the better judgment of the shipmaster and without the knowledge and consent of the owner.

Turning now to the terminal expression "covering all other perils, losses, and misfortunes, etc.," it would seem that the underwriter is liable for losses arising from all causes not specifically mentioned. Apparently the phraseology includes all possible perils. Yet the real intent of the policy is to limit the liability of the insurer to losses resulting from causes similar to those enumerated before, i.e., to those losses which are due only to accidental causes connected with the sea, and which result from the action of the elements or from other overpowering and unavoidable occurrences, and not from any inherent defect of the subject insured, or from natural causes, such as deterioration, wear and tear, etc., in so far as they are inevitably associated with the usual prosecution of the journey.

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[1] Joseph Arnold, "On the Law of Marine Insurance," Vol. II, p. 952, sec. 839.

# CHAPTER XXVI

## THE TYPES OF LOSSES ARISING FROM MARINE PERILS

Having discussed the nature of the perils against which protection is granted, we may next inquire into the form which the losses arising from such perils may take, and the extent which the underwriter's liability may assume. Here we meet with a number of terms which appear again and again in the discussion of marine policy provisions. These terms refer (1) to "total loss," which may be either "actual total loss" or "constructive total loss," and which involve a discussion of "abandonment"; (2) "general average"; (3) "particular average"; and (4) "salvage."

1. *Total Loss.*—"Actual total loss," as the term suggests, has reference to those cases where the subject matter of the insurance is completely destroyed or "missing," or is so badly damaged as to be of little or no value to the insured, or is taken out of the possession of the insured so as to completely deprive him of its use. "Constructive total loss," on the other hand, has been defined as occurring "when the subject matter insured, though existing in specie, is justifiably abandoned on account of its destruction being highly probable, or because it cannot be saved from actual total loss, unless at a cost greater than its value would be if such expenditure were incurred."[1] To illustrate this definition we need only refer to a vessel which, having run upon

[1] Frederick Templeman, "Marine Insurance: Its Principles and Practice," p. 45.

rocks, has been but slightly injured, and only requires to be released. Yet the cost of freeing this vessel from its position may be so large when compared to its value afterwards that the attempt can only be characterized as a commercial failure. Hence it is that this and all similar cases are technically termed "constructive total losses"; and, if the facts of the case warrant it, the interests of the insured demand that he should give the underwriter of the risk what is called a "notice of abandonment." By this is meant that the insured claims payment for a total loss, and is willing to surrender to the underwriter all that remains of the property insured. If the underwriter accepts this notice of abandonment, he will pay the total valuation stated in the policy, and will seek, if practicable, to reimburse himself, at least in part, by recovering as much as possible of the property thus abandoned.

In the case of the vessel, "constructive total loss" exists whenever the cost of saving her from her position, plus the cost of repairing her damages, would exceed the value of the vessel when thus restored. In the case of a cargo, such a loss may be declared when the goods fail to arrive at the port of destination, and when the cost of restoring any loss or damage, and of forwarding the cargo to its final destination, amounts to more than the goods are worth after thus being repaired and forwarded. Lastly, in the case of freight, "constructive total loss" exists when the vessel or cargo is in such a condition that to save the freight from actual total loss would require an outlay greater than the value of the freight after such expenditure is incurred. In all these cases it must always be remembered that both the insured and underwriter must act without undue delay in giving and accepting the notice of abandonment, and that neither may wait to form an opinion by observing developments.

2. *General Average.*—Turning next to a consideration of partial losses, the subject which claims our special attention

is that of "average," which involves a discussion of the terms "general average" and "particular average." General average may be defined as covering all those losses which result from the sacrifice of any interest voluntarily and deliberately made by the master of a vessel in time of distress for the common safety of the ship, cargo, and freight, and which must be repaid proportionately by all the parties benefited. Justice demands, for example, that if a shipowner cuts away the masts and sails, or voluntarily strands his vessel, or incurs expenses by putting into a port of refuge for the sake of preserving the cargo, he should not be obliged to bear the loss alone. Likewise, if an owner's cargo is sacrificed in quenching a fire aboard the vessel, or is thrown overboard to save the vessel, it would be grossly unjust to make that owner stand all the loss. Hence the introduction of the principle that all such sacrifices should be compensated for by making them a charge upon the value of all the other interests involved.

In the case of the vessel a loss in "general average" exists only when any part has been destroyed in time of danger, for the common safety, or when for the same reason it has been put to a use for which it was not intended. The cutting away and throwing overboard of masts, spars, and sails, or the injuring of a steamer's propeller while attempting to extricate it from a dangerous position are a few of the many illustrations that might be mentioned. While very complex cases for settlement may arise, the amount ordinarily collected in "general average" in all such cases is the reasonable cost of repairs, after deducting the customary allowance (usually one third) which is granted as a commutation for the difference between old and new repairs. In the case of the cargo the amount allowed usually equals the net value which the goods would have brought when discharged, after deducting the charges for freight, landing, etc., which would have been incurred had the goods not been lost. If,

however, the goods are merely damaged, the amount allowed is the difference between the net proceeds when sold and the value which they would have had if undamaged. When freight is lost the sum allowed ordinarily consists of the gross freight which the vessel would have earned had the goods been saved, after deducting: (1) The charges which would have been incurred in order to carry the freight had the goods been saved; and (2) any freight which may be earned by carrying goods which are substituted at a port of call in place of those which were sacrificed.[1]

The various amounts thus ascertained are then levied upon the value of all the interests which were saved from destruction by the general average act. Usually the vessel, in case it is one of the contributory interests, contributes on the value it possesses upon arrival at the port; the freight contributes on the net amount of freight saved; while the cargo contributes upon its net value at the port of landing. The guiding principle in making all these contributions is that the person whose goods were sacrificed should be placed in exactly the same position as he would be if the goods of some other person had been sacrificed for the common safety. To bring this about it is necessary that the sacrificed interest should also contribute its proper share. To return the sacrificed interest in full without claiming the proper contribution would mean placing the owner of the same in a favored position, since he would recover his property in full, while the other owners would be asked to make a contribution. Thus assuming the ship, cargo, and freight to be worth respectively $50,000, $25,000, and $1,000, and that $5,000 of this has been jettisoned, the following apportionment of general average would be made:

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[1] For a very comprehensive discussion of General Average in Marine Insurance, see William Gow's "Marine Insurance: A Handbook," Fourth Edition, 1909.

Total value contributing.......$76,000, contributing to a loss of............$5,000.00

Property saved.......$71,000, contributes $\frac{71}{76}$ of $5,000, or............4,671.06

Property jettisoned.......$5,000, contributes $\frac{5}{76}$ of $5,000, or............328.94

Ship valued at $50,000.......contributes proportionately, or............3,289.47

Cargo, net value $25,000.......contributes proportionately, or............1,644.74

Freight, net amount $1,000.......contributes proportionately, or............65.79

It should always be remembered that the liability for general average contributions and the right to claim it are matters which are entirely independent of marine insurance. If no insurance exists on any of the property involved, the respective owners must bear the contributions themselves. If, however, the property sacrificed is insured, then the underwriter becomes liable for the insured value, and by paying the same, comes into possession of the right to receive the sums allowed in general average after deducting the contribution which applies to the interest he now represents. Moreover, if the contributing interests are insured, the underwriter is also liable for general average damage. But in determining the extent of his liability for such contributions, the insured value of the property must be taken into account. If the insured value is equal to the value of the contributing interest, the underwriter pays all the general average contributions; but if it is less, he only pays the contribution in the proportion which the insured value bears to the contributory value.

3. *Particular Average.*—This term comprises all partial losses occurring to the ship, cargo, or any other interest in consequence of marine perils which do not come under general average. While "general average" refers to losses arising from voluntary sacrifice, particular average refers to

losses resulting from accident. No sacrifice is made in particular average for the common benefit; no claim can therefore be made for compensation by general contribution. The loss must fall exclusively upon those who own or have an interest in the property lost or damaged, unless the same is insured, in which case restitution is made by the insurer.

Generally speaking, the underwriter's liability for particular average on hulls is measured by the reasonable actual cost of repairs after deducting "one third new for old" (the allowance frequently made as a commutation of new for old), and after crediting the underwriter with the value of the old material. In the case of a damaged cargo, the liability is usually represented by the difference between the gross sound value of the goods and the gross proceeds obtained from their sale, the percentage of loss thus ascertained being then applied to the amount of insurance carried. In the case of freight, the underwriter's liability is based on the insured value of the freight, and varies in proportion to the extent that the cargo is lost.

4. *Salvage.*—By salvage in marine insurance is meant the reward granted by law for services in saving life and property at sea. To be a true case of salvage, the service must have been of material assistance in saving the property, and must have come from third parties. The sum payable for the service is usually apportioned over the values of the various interests saved, just as in the case of general average, and is recovered from the underwriter in exactly the same manner, provided the contributing interests are insured.

# CHAPTER XXVII

## POLICY PROVISIONS PROTECTING THE INSURER AGAINST FRAUD, UNNECESSARY LOSS, AND UNDESIRABLE RISKS

Much the larger part of every marine policy consists of provisions which have for their object the protection of the insurer against fraud, unnecessary losses, and undesirable risks. The whole number of such provisions in the policies of the leading companies cannot be given here, and only those provisions which are now generally included in the policies of the principal companies will be presented. In doing this it is convenient to group these provisions under the following heads:

1. *Other Insurance upon the Same Subject Matter.*—That part of the marine policy relating to "other insurance" has reference to the liability of the insurer where the same property has been insured with two or more companies. In England this problem is solved by granting the insured the right to collect indemnity from whichever policy he pleases, the underwriter of this policy in turn possessing the right to collect a ratable contribution from the other underwriters who insured the same risk. Thus, where, without intention to commit fraud, the same property is insured equally with two companies, the insured may collect the whole loss from one company, which, in turn, will collect from the other one half the sum thus paid. Where the sum insured is not the same for both underwriters, the case is considered one of double insurance of the amount represented by the smaller of the two policies.

As compared with the above rules, the practice in the United States is different. Instead of permitting the insured to collect from any policy he may choose, the liability of the underwriters depends upon the date of the policy. If its policy is the first one taken, and covers the value of the interest, then it alone must bear the loss. Only when the amount insured by the first policy fails to cover the value of the interest lost, do the later policies become contributors. In accordance with this principle, practically all American policies provide that "it is hereby agreed that if the said insured shall have made any other insurance upon the property aforesaid, prior in date to this policy, then the said insurance company shall be answerable only for so much as the amount of such prior insurance may be deficient toward fully covering the property hereby insured, and the said insurance company shall return the premium upon so much of the sum by them insured as they shall be by such prior insurance exonerated from; provided no return premium shall be made for any passage whereon the risks have once commenced. And in case of any insurance upon the said property subsequent in date to this policy the said insurance company shall nevertheless be answerable for the full extent of the sum by them subscribed hereto, without right to claim contribution from such subsequent insurers, and shall accordingly be entitled to retain the premium by them received, in the same manner as if no such subsequent insurance had been made." Most American policies also stipulate that "other insurance upon the premises aforesaid, of date the same day as this policy, shall be deemed simultaneous herewith, and the company shall not be liable for more than a ratable contribution in the proportion that the sum by them insured bears to the aggregate of such simultaneous insurance."

2. *The "Sue and Labor" and "Waiver" Clauses.*—The universal employment of these clauses in marine policies justifies their reproduction in full, namely: "And in case of

any loss or misfortune, it shall be lawful and necessary for the insured, his or their factors, servants, or assigns, to sue, labor, and travel for, in, and about the defence, safeguard, and recovery of the said property or any part thereof, without prejudice to this insurance; to the charges whereof the said insurance company will contribute in proportion as the sum insured is to the whole sum at risk; and the acts of the insured or insurers in recovering, saving, and preserving the property insured in case of disaster, shall not be considered a waiver or acceptance of an abandonment." The insured, in other words, agrees to exert himself in preventing or minimizing the loss of the insured property in the same manner that he would if uninsured. The company, in turn, promises to bear all expenses thus honestly and prudently incurred by the insured in a proportion such that if the policy covers the full value of the interest it will pay all "sue and labor" charges. Both insured and underwriter then agree that no act of theirs coming under the "sue and labor clause" shall constitute a waiver or an acceptance of an abandonment.

3. *The "Memorandum."*—This clause may be defined as consisting of an enumeration of articles arranged in groups, concerning which there is a limitation of the underwriter's liability for particular average. In its original form Lloyd's policy placed no limit upon the liability of the insurer. The development of the marine-insurance business, however, and the growing complexity of commerce soon demonstrated that some limitation was essential. Hence, in 1749, a clause called the "memorandum" was inserted, according to which the most important articles of trade were classified into three groups, and each group subjected to a definite limitation as regards the liability of the underwriter. A similar limitation was introduced in American policies in 1840, and to-day the Memorandum is a conspicuous feature in every cargo policy. Indeed, so detailed has the "memorandum" become

in some cases that in the policy of one important American company it limits the liability of the insurer with respect to one hundred and twenty specified articles or classes of articles. Changes have been made from time to time in the memorandum to meet the needs of commerce in different places, so that no uniformity can be claimed with respect to the articles enumerated in different policies. As illustrative of the classes into which commodities are grouped, the following is given as a general form:

*Memorandum.*—It is agreed that bar, bundle, rod, etc., etc., ............are warranted by the assured from average, unless general; cassia, matting, etc............free from average under 20 per cent unless general; East India hemp, etc............free from average under 10 per cent unless general; bread, flax, etc. ............free from average under 7 per cent unless general. Agricultural implements, etc.............warranted free from claim or for any breakage, but liable for a total loss of a part if amounting to 5 per cent.

In ascertaining whether the memorandum percentages have been reached, no consideration can be given to general average; nor can extra charges for proving the claim or making the survey be included in the loss in order to obtain the percentage. Regard can be had only to particular average, and if the claim here exceeds or equals the percentage mentioned, then the whole damage (not merely the excess), plus the extra charges, must be borne by the underwriter. If, however, the actual value exceeds the insured value, the underwriter pays only a proportionate part of the charges, otherwise he pays all; while all charges incurred for saving and preserving the property are recoverable, as we have seen, under the sue and labor clause.

In voyage policies it is permissible to make the insurer liable by combining successive losses, each of which is less than the stipulated percentage. On the other hand, in time policies only the losses of one round voyage can be combined

to determine the percentage, and not all losses incurred during the whole period covered by the policy. Moreover, in view of the increasing size in vessels and cargoes, it soon became apparent that although the percentage mentioned might be small, the absolute loss represented thereby might be unduly large ($5,000, for example, on a cargo of $50,000 under the 10-per-cent limitation). Consequently it has become common to subdivide risks as regards the application of percentages. Thus a cargo may be subdivided into "series," each "series" depending on the nature of the subject matter (as a certain number of bales for cotton, or chests for tea, etc.), and the underwriter made liable where the loss in respect to one of these series reaches a proper percentage. Likewise, in the case of a vessel, separate valuations are often introduced for the hull, machinery, etc., with provision that the percentage rule should apply to each valuation separately.

4. Closely resembling the agreement in the "memorandum" are the provisions (some of which are at times included in the memorandum) usually found in policies which grant exemption:

(1) From loss to goods "by dampness, rust, change of flavor, or by being spotted, discolored, musty, or moldy," unless caused by contact with sea water and occasioned by sea perils.

(2) From loss by wet or exposure of goods shipped on deck; or for leakage of certain liquids like oils, molasses, etc., unless caused by stranding or collision.

(3) From loss of freight on articles like ice and lime, unless the entire quantity be destroyed because of stranding, sinking, or fire; nor for loss of the articles themselves, unless occasioned by jettison, stranding, sinking, or fire.

(4) From loss of specie, bullion, jewels, bank notes, deeds, and the like, by providing that they "are not deemed to be included in any insurance unless specially mentioned in the policy and scheduled."

(5) From partial loss or particular average on a vessel unless amounting to a certain percentage, usually 5 per cent net of the value declared, exclusive of expenses in adjusting and proving the loss.

(6) From loss of freight or interest on the vessel unless amounting to 5 per cent net, exclusive of expenses.

(7) From loss on account of wages or provisions, except in general average when customary.

(8) From loss occasioned by jettison of deck cargo.

(9) From loss by breakage or derangement of machinery, or bursting of boilers, unless caused by stranding, collision, or fire.

5. *Subrogation.*—This is the right by which an underwriter becomes entitled to all rights and remedies which the insured himself could have exercised in respect to any loss. This right is always granted in marine policies, and the usual wording of the clause is as follows: "In case of loss under this policy it is expressly stipulated that the insurers shall be subrogated to all rights of the insured against any persons or corporations whose acts, negligence, or default may have caused or contributed to the loss.

6. *Provisions Facilitating the Adjustment of Claims.*—Among such provisions most frequently used in American policies are those which stipulate:

(1) That in case of loss the company's agent must be represented on the survey, if there be one at or near the place; and, if not, then an agent of the National Board of Marine Underwriters, which agent must approve all bills for repairs or expenses.

(2) That in case of any dispute arising with reference to a loss on the policy the matter may be submitted to arbitrators mutually chosen, whose award shall be final.

(3) That the insured shall give immediate notice of loss, together with an account of all known particulars and attending circumstances.

(4) That the company shall have free access at all reasonable hours to the books, accounts, instructions, and correspondence relating to shipments and receipts covered by the policy.

7. *Statement of Acts which Render the Policy Void.*—In addition to the general principle already noted, that the misrepresentation or concealment of any material fact will nullify a policy, it is customary in most policies to declare the contract void for one or more of the following reasons:

(1) "In case of any agreement or act, past or future, by the insured, whereby any right or recovery of the insured, against any persons or corporations, is released or lost, which would, on acceptance of abandonment or payment of loss by this company, belong to this company but for such agreement or act, or in case this insurance is made for the benefit of any carrier or bailee of the property insured, other than the person named as insured."

(2) In case the policy or the interest therein is sold, assigned, transferred, or pledged, without obtaining in writing the previous consent of the insurers.

(3) If any claim for loss arising under the policy is not prosecuted within one year from the date of happening.

(4) If a vessel upon a regular survey should be declared unseaworthy on account of being unsound.

8. *Miscellaneous.*—Under this head may be grouped the many scattered provisions, clauses, and warranties which are found in examining a large number of policies. To enumerate them all is quite impracticable, so an attempt will be made, therefore, merely to indicate their nature by giving the principal groups under which they may be classified. In the main these groups are seven in number, and include:

(1) Those provisions which exempt the underwriter from loss arising from capture, seizure, detention, or other acts of force; or which protect the underwriter from loss on account of illicit trade, or trade in contraband of war, or which

forbid abandonment except under certain specified conditions.

(2) Those exempting the underwriter from the payment of certain losses and expenses, or from paying for certain repairs, such as the customary deduction of one third from the cost of all repairs on a vessel, except where otherwise provided, as a commutation for the average difference between new and old.

(3) Those which forbid the insured to use certain ports, routes of travel, or areas of water, or else limit their use to certain months in the year.

(4) Those which prohibit, restrict, or otherwise regulate the carrying of certain articles.

(5) Those referring to the collection or return of the premium, such as the right to cancel a policy and collect the earned premium in case of the bankruptcy of the insured, or the right to retain the whole premium in case the voyage is terminated before the expiration of the policy.

(6) Those arranging for payment of losses within thirty or sixty days, as the case may be, after receipt of the proof and adjustment of the loss, together with the proof of insurable interest, and after deducting all sums due to the company.

(7) Those granting the shipmaster liberty of action in time of danger, such as proceeding to another port in case the port of destination is blockaded, or in case stress of weather or unavoidable accident makes this imperative.

# CHAPTER XXVIII

## SPECIAL AGREEMENTS INDORSED ON MARINE POLICIES

THERE is an almost endless variety of clauses or riders attached to marine policies in order to express special agreements entered into by the contracting parties with a view to changing or supplementing the provisions contained in the printed form of the policy. These clauses are usually either printed, written, or stamped on the margin of the policy, and very frequently, to make their importance conspicuous, are introduced in red or blue print. But, whatever the form in which they may appear, or however contrary to the printed portion of the policy they may be, they are binding upon the parties to the contract, in view of the principle that any writing in the policy or any printed clause attached thereto is regarded as a special agreement, and as taking precedence over the printed matter in the main body of the policy itself. Owing to the exceedingly large number and variety of such clauses in use, it is next to impossible to attempt an enumeration of them. How large the number is may be judged from the fact that Mr. Douglas Owen, in his collection of them in his work on "Marine Insurance Notes and Clauses," required a volume of over two hundred and fifty pages. Despite their number, however, there are certain clauses of such frequent use as to deserve special mention.

1. *The Collision Clause.*—This clause first came into general use after 1836, in which year it was decided by a British court that an underwriter was not liable under the ordinary wording of the marine policy for damages caused by

the insured vessel to another vessel through collision, even though the insured vessel was at fault. Hence, although the damage suffered by the insured vessel through collision is covered by a marine policy, it became necessary, in view of this decision, to make a separate contract whereby the underwriter would agree to assume liability for the damage caused to the other vessel. Accordingly it became common to insert a clause which made the insurer liable for all or a portion of the damage thus incurred, and to-day the use of the so-called "collision clause" has become well-nigh universal. Its general use and great importance will justify its reproduction here in the form in which, with few exceptions, it is found in American policies, viz.:

"It is agreed that if the vessel hereby insured shall in consequence of collision with another vessel become liable to pay, and shall pay any sum or sums for damages resulting therefrom to said other vessel, her freight, or her cargo, in such cases this company will contribute toward the payment of three fourths of the total amount of said damages in proportion that the sum insured under this policy bears to the total valuation of the vessel as herein stated, provided that this company shall not in any event be held liable under this agreement for a greater sum than three fourths of the amount insured under this policy.

"And it is also agreed that this company will bear a like proportionate share of the costs and expenses that may be incurred in contesting the liability resulting from said collision, provided the written consent of the company to such contest be first obtained.

"But under no circumstances shall this company be held liable for any contribution in respect of any sum that the assured may be held liable to pay, by reason of loss of life, or personal injury to individuals from any cause whatsoever."

2. *The "Free from Particular Average Clause,"* which signifies that the insurer is not liable for loss resulting from particular average. In most cases provision is made that the clause shall not apply "unless the vessel be stranded, sunk, burned, or in collision"; while some companies use the phrase, "unless caused by the perils enumerated."

3. A clause exempting the underwriter from "loss on account of capture, seizure, detention, or destruction by or arising from hostile forces, civil commotions, riots, or by the acts of officers, or other persons acting in the name of belligerents, or in pursuing warlike operations, whether before or after a declaration of war." The risks growing out of war, as has been said, are "deemed greater than all the perils enumerated in the policy."[1] Thus by inserting the above clause the underwriter relieves himself from liability on account of a risk which in itself would require a very substantial increase in the premium charge.

4. Among the numerous other clauses in use which might be mentioned, are those which provide that all risks insured are to be considered as underdeck unless otherwise specified; which prohibit the insured from trading in certain places or from carrying certain commodities; which grant the vessel certain liberty of action in case of certain contingencies; or which relieve the company from being answerable for certain defined losses, or from damage arising in consequence of specified actions or events.

## WARRANTIES AND REPRESENTATIONS

Very frequently special agreements in marine insurance are declared by the policy to be warranties. In no other form of insurance does the term "warranty" appear so often as in the marine policy. For this reason an explanation of the term is desirable, especially in view of the fact that its application in marine insurance is quite different from that in fire insurance.

The chief distinction between a "warranty" in a marine-insurance policy and a "representative" is found in the strictness with which they must be fulfilled. Compliance with both is necessary to maintain the validity of the con-

[1] A. A. Raven, in "Yale Insurance Lectures," 1903–04, p. 193.

tract. In the case of the warranty, however, compliance must be "absolute and literal" or the policy becomes void from the moment of non-compliance, while as regards a representation, "equitable and substantial fulfilment" is sufficient. In other words, a warranty is either, as Arnold defines it, "A stipulation inserted in writing (or printed) on the face of the policy, on the literal truth or fulfilment of which the validity depends,"[1] or else is, as Gow expresses it, "A fundamental and essential factor or condition inherent in each and every contract of marine insurance, without exceptions."[2] A representation, on the other hand, is a statement in the policy less formal and severe than the warranty. The most important thing connected with the representation is the determination of whether or not it is a material statement, i.e., whether or not it has been one of the causes which led the underwriter to accept the risk, or influenced him in fixing the premium.

The term "warranty" as used to-day may have two different meanings. In the first place, there is the strict meaning of the term as exemplified by the definitions cited by Arnold and Gow. Among the warranties coming under this meaning may be mentioned certain "implied warranties," to be described presently; or those which oblige the vessel if trading to certain places, to sail within the time prescribed by specified dates; or which prohibit the vessel from carrying certain articles, like combustible or injurious chemicals, or from taking a certain route, or from trading in certain prohibited areas; or which forbid loading the vessel beyond a certain limit with specified articles. On the other hand, the term "warranty" is often spoken of as referring to statements which are opposed to the usual provisions of the pol-

[1] Arnold, "Treatise on the Law of Marine Insurance and Average," p. 625.

[2] William Gow, "Marine Insurance," p. 260.

icy, and which aim to relieve the company from certain losses for which it would otherwise be liable. Among such statements, commonly found in marine policies, are those freeing the underwriter from loss on account of capture, seizure, or detention by any power or persons, or loss arising from abandonment under certain conditions, or in consequence of the jettison of certain articles, and a host of similar provisions (often including the memorandum and the "free from particular average" clause) too numerous to permit of mention here. Such provisions are frequently introduced by the words "warranted free from," and have consequently acquired the name "warranties," a practice, no doubt, favored by underwriters, because the term "warranty," if applied to statements favorable to the insurer would, owing to the strict interpretation attached to the term, be more apt to render their fulfilment certain by the insured.

Viewing warranties from another standpoint, they may be either "expressed" or "implied," according as they are written or printed on the face of the policy, or are of such fundamental importance that their application is universally acknowledged in marine insurance without appearing in the policy. "Expressed" warranties need claim but little of our attention, since the warranties cited above belong to this class. But when we consider "implied" warranties we reach a subject which underlies and vitally affects every contract of marine insurance. In fact, the conditions of these "implied" warranties must be present in every risk before any policy can be legally enforced, and non-compliance with any of their provisions will render the policy null and void. Briefly stated, implied warranties are three in number and provide:

1. That the vessel must be seaworthy in all respects for the intended voyage at the time of starting. This implies that the vessel must be in proper condition as regards the hull, machinery, rigging, the supply of fuel and provisions,

the size and stowage of the cargo, the efficiency and sufficiency of the crew, and in all other particulars which, in view of the ordinary perils apt to be encountered, are essential in successfully prosecuting the voyage and carrying the cargo described in the policy. If the voyage is to be divided into several separate stages, this warranty applies at the beginning of each stage. Moreover, when a different equipment is necessary, where, for example, part of the voyage is by river and part by sea, the warranty is nevertheless applicable as regards each stage.

2. That the vessel will proceed in the usual way, directly and without deviation or unnecessary delay, from the port of departure to the port of destination. Only where deviation is permitted or required by the policy, or made necessary by overpowering circumstances or the desire to protect human life, or aid in saving a vessel in distress or the subject matter insured, or where non-compliance is due to barratry of the master and mariners, and this is covered by the policy, is there a justifiable excuse for failure to observe this warranty. And where any deviation has occurred and the cause has disappeared, it is essential that the vessel should without undue delay resume the voyage. Failure to do so will be construed as another deviation, and will nullify the policy.

3. That the adventure shall be legal in all particulars. This implies that the vessel will conform with all legal requirements regarding her papers, and will refrain from engaging in any unlawful trade.

All these implied warranties will appear just upon reflection, and the public interest demands that they should be observed. Yet, despite their importance, it is only in recent years that they have been given full effect. The original bills of lading used in shipping cargoes did not exempt the carrier from responsibility for loss or damage unless resulting from unavoidable causes. From time to time. how-

ever, this responsibility of the carrier was limited through the insertion of stipulations in bills of lading providing against responsibility for loss resulting from the unseaworthiness of the vessel, negligence of master or crew, and other avoidable causes. As the decisions of the courts subjected the carrier from time to time to new liabilities, additional clauses were introduced into the bills of lading to obviate these decisions. As a consequence, the responsibility of vessel owners was reduced to a minimum, and conditions remained in this shape until the year 1893, when Congress passed the so-called Harter act. This act nullified every agreement seeking to relieve the carrier from responsibility for the loss caused by negligence or failure in properly loading and caring for the freight, and at the same time provided that if the ship owner should render the vessel seaworthy in all respects, no responsibility was to attach to any loss which arose from error in navigating or managing the same.

# *PART THREE*

# BONDING.—TITLE AND CREDIT INSURANCE

## CHAPTER XXIX

### CORPORATE SURETYSHIP

THE giving of surety for the fidelity of others seems to date from very ancient times; but, until about the middle of the nineteenth century, the practice was confined exclusively to individuals as distinguished from corporations. Just as individual underwriting in fire and marine insurance proved inadequate for the modern business community, so personal surety was found to have many shortcomings. Persons of means, although reluctant to impair their financial credit by assuming the contingent liability connected with the giving of a bond, found it difficult to refuse to qualify on the bond of a friend who asked for the favor. Those who were required to furnish bonds, and had to secure the same from personal friends, thereby placed themselves in a position where they felt bound to return the favor. In many instances worthy persons, for no other reason than that they had no wealthy friends to go surety for them, could not accept positions of trust and responsibility. In other instances again, the giving of surety was made the excuse for exercising undue influence over officers, officials, and employees. But, above all, the greatest drawback of personal surety was its lack of supervision over the conduct of the person bonded, and its unreliability when it came to the collection of the bond. Such bonds were frequently granted by friends in a haphazard way, largely on the supposition that it was, of course, nothing more than a mere form. When the unexpected happened, and the bond could not be paid, it became apparent that the giver of the bond had assumed

a big risk when he became surety for a person over whose conduct he had little or no control, and that the person requiring the bond was foolish in placing his dependence upon an individual guarantor, whose financial resources were changeable and difficult to estimate.[1]

When the disastrous results of these various drawbacks of personal surety became widespread, business men began to demand, just as they did in fire and marine insurance, that corporations with large capital and efficient organization should enter this field. The business man desires certainty in insurance above all else, and this can be had only if the underwriter is financially strong, and enables the insured to

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[1] The advantages of corporate suretyship have been succinctly stated by Mr. Edwin Warfield, President of the Fidelity and Deposit Company, of Baltimore, Md. He groups the advantages under seven heads. "(1) It relieves business men and persons possessing property from the necessity of saying 'no' to friends and relatives who may ask them to qualify on bonds of various kinds, which, if they did, would create a contingent liability, impair their financial credit, and involve a possible loss. (2) It enables heirs and next of kin to become trustees, executors, and administrators of the estates of their deceased relatives, and to keep the management thereof in the hands of those most interested in a speedy, cheap, and proper settlement. (3) It relieves those required to give bonds from incurring obligations by asking friends to become surety for them, and which they would feel bound to reciprocate when the opportunity offered. (4) It removes all liability or excuse for undue influence being exercised over bank officers, railroad employees, contractors, and public officials, by those becoming surety for such officials. (5) It insures a supervision over a person bonded, or the estate or interest involved, that will be an incentive to right-doing and a proper accounting. (6) It guarantees prompt payment of losses, avoids litigation, and enables the official or employer to know the responsibility of the security furnished them. (7) It often enables persons who have no property or friends of financial standing, to obtain positions of trust and emolument."

ascertain this fact from a regularly published financial report. The value of corporate surety seems first to have been recognized in England. Here, in 1840, the "Guaranty Society of London" began to guarantee the fidelity of persons who held responsible positions in business. It is a noteworthy fact that corporate bonding became an important business in England long before its introduction in the United States.

The first company to write surety bonds in the United States was the Guarantee Company of North America, a Canadian corporation. This company began business in this country in 1872, but limited its bonds to the officers of banks, railroads, and corporations generally. The state of New York had passed an act in 1853 authorizing the incorporation of such companies, but it was not until 1875 that the first company was incorporated. In 1884, the American Surety Company of New York was formed, and went a step further than the Guarantee Company of North America by guaranteeing bonds required for court undertakings and for contractors and fiduciaries. Next, in 1890, the Fidelity and Deposit Company of Maryland was organized; which, in addition to issuing all the bonds of its predecessors, made a new departure in bonding public officials of all kinds—whether national, state, county, or municipal.

The method by which this company sought to obtain a foothold is well explained by its president, Mr. Edwin Warfield, and shows how little the advantages of corporate suretyship were understood, even at this late date. "There were many business men," declares Mr. Warfield, "who said: 'You can't make a company like that go; the business is risky, and there is no future to it.' . . . I found that the public did not appreciate the advantages of the character of suretyship we offered, and that we had a campaign of education before us. We had to educate public officials, we had to educate commissioners, we had to educate judges and

men who approve bonds, up to the advantages of corporate suretyship. At that time the government of the United States was limited in this matter to the approval of individuals as surety upon bonds, and we had to secure legislation in that direction. Finally, in 1894, we succeeded in having passed by Congress an act that authorized the approval of corporations as sole surety upon bonds given by public officers and in all judicial proceedings in the United States courts. Then it was necessary to get into the various states; and we found few states had laws that authorized the acceptance of corporations as sureties upon the bonds of public officers or in court proceedings."

*Present Extent of the Corporate Bonding Business.*—Owing to the campaign of education which several of the companies waged and the readiness with which business men acknowledged its many advantages, corporate suretyship has enjoyed a most remarkable growth. Although its beginning in this country dates back only to 1872, corporate bonding was represented, in 1909, by over thirty companies, one of which had total assets of nearly $10,000,000, five over $5,000,000 each, and eleven in excess of $1,000,000. According to the following table, eighteen leading companies doing a bonding business, possessed in 1909 total assets of $52,975,490, and a surplus of $14,861,161. The fidelity and surety risks of these companies in force showed a total of $3,512,808,820, and the premium income amounted to $12,826,693, as compared with losses of $3,347,239. The ratio of losses paid and claim expenses to the premium income was 29.7 per cent, and the average rate for risks as based on the penalty of the bond was .361 cents per hundred.

Not only has the corporate bonding business attained large proportions financially, but it has constantly extended its field of usefulness by increasing the variety of bonds issued. The almost unlimited sphere of usefulness of this

## THE BUSINESS RECORD OF FIDELTY AND SURETY COMPANIES FOR THE YEAR 1909

| Name of Company. | Total Assets. | Surplus. | Fidelity Risks in Force. | Surety Risks in Force. | Premiums Received. | Losses Paid. | Ratio of Losses Paid and Claim Expenses to Premiums. |
|---|---|---|---|---|---|---|---|
| | | | | | | | Per Cent. |
| Ætna Indemnity Co., Hartford | $879,786 | $84,864 | $20,700,741 | | $72,316 | $27,667 | 38.8 |
| | | | | $60,232,347 | 215,976 | 114,959 | 68.1 |
| American Bonding Co., Baltimore | 2,514,582 | 747,152 | 86,567,210 | | 256,046 | 32,972 | 15.7 |
| | | | | 219,378,145 | 669,903 | 145,301 | 26.4 |
| American Fidelity Co., Montpelier, Vt. | 885,702 | 80,055 | 9,884,502 | | 29,070 | 2,960 | 11.3 |
| | | | | 6,252,277 | 40,062 | 4,506 | .... |
| American Surety Co., New York | 7,643,460 | 3,127,839 | 276,425,045 | | 1,067,823 | 238,585 | 24.3 |
| | | | | 3,127,839 | 1,246,796 | 163,798 | 13.1 |
| Empire State Surety Co., New York | 1,386,235 | 104,581 | 47,950,555 | | 96,132 | 8,484 | 12.5 |
| | | | | 68,550,466 | 369,708 | 109,558 | 39.7 |
| Employers' Liab. Assur. Corp., London and Boston | 5,063,420 | 1,911,982 | 38,801,400 | | 94,915 | 22,659 | 25.2 |
| Fidelity & Casualty Co., New York | 9,598,924 | 2,564,230 | 86,699,884 | | 361,545 | 53,727 | 19.0 |
| Fidelity & Deposit Co., Baltimore | 6,237,835 | 2,513,644 | 341,805,982 | | 1,175,215 | 612,264 | 36.5 |
| | | | | 231,205,562 | 372,079 | 291,546 | 81.6 |
| Illinois Surety Co., Illinois | 547,537 | 108,868 | 25,496,420 | | 108,867 | 17,652 | 18.7 |
| | | | | 19,398,074 | 215,187 | 43,384 | 21.9 |
| Massachusetts Bonding & Insurance Co., Boston | 1,066,119 | 206,828 | 41,418,175 | | 144,373 | 3,544 | 2.8 |
| | | | | 33,615,531 | 247,244 | 31,223 | 13.4 |
| National Surety Co., New York | 3,864,016 | 1,004,769 | 302,249,507 | | 939,229 | 234,797 | 29.0 |
| | | | | 279,381,471 | 1,165,588 | 160,055 | 16.4 |
| American Accident & Guarantee Co., New York | 3,854,570 | 1,270,054 | 1,630,250 | | 3,959 | | .... |
| Pacific Surety Co., San Francisco | 444,074 | 125,135 | 21,118,728 | Fidelity and surety comb. | 79,289 | 54,100 | 73.1 |
| People's Surety Co., New York | 815,346 | 256,838 | 6,852,310 | | 27,736 | 4,608 | 17.3 |
| | | | | 9,402,499 | 70,927 | 309 | 3.1 |
| Home Accident Insurance Co., Fordyce, Ark. | 589,378 | 34,402 | | | 182 | | .... |
| | | | | 55,000 | | | .... |
| Southern Surety Co., Muskogee, Okla. | 656,035 | 74,459 | 5,092,200 | | 17,154 | 52 | 0.3 |
| | | | | 12,157,353 | 83,350 | 1,454 | 2.1 |
| U. S. Fidelity & Guarantee Co., Baltimore | 5,213,887 | 512,808 | 825,045,495 | Fidelity and surety comb. | 2,936,022 | 864,878 | 33.5 |
| United Surety Co., Baltimore | 1,114,584 | 92,653 | 6,566,744 | | 58,351 | 5,360 | 13.1 |
| | | | | 68,108,455 | 517,649 | 96,837 | 21.1 |
| Totals | $52,975,490 | $14,861,161 | $2,144,305,148 | $1,368,503,672 | $12,682,693 | $3,347,239 | 29.7 |

form of insurance is made clear by Mr. J. Frank Supplee,[1] in his classification of the different departments of a bonding company and the various classes of risks included under each. Briefly summarized, Mr. Supplee's classification shows corporate surety bonding to cover the following:

1. *The Banking Department*, embracing surety desired by bankers, trust companies, and financial institutions having banking features.

2. *The Fidelity Department*, embracing bonds required from (a) bookkeepers, salesmen, collectors, cashiers, treasurers, and office men generally; (b) national, state, county, and city officials and their deputies and clerks; (c) officers and employees of fraternal and beneficial societies.

3. *The Judicial Department*, including bonds for executors, administrators, and those filed in bankruptcy proceedings, and upon replevin, trustee, receiver, guardian, attachment, injunction, supersedeas, appeal, security for costs, committee, assignee in insolvency, indemnity to sheriff, to release an attachment, and to dissolve an injunction.

4. *The Transportation Department*, embracing bonds required by steam and electric railroads and express companies. These bonds may be for their employees or shippers, or may be demanded by the federal or local government.

5. *The Contract Department*, including bonds which cover the almost unlimited variety of private, municipal, state, and federal contracts.

*The Computation of the Premium.*—When a surety company executes its bond it does so largely on the theory that in all probability it will never have occasion to pay the same. In issuing a fidelity policy, for example, the company first thoroughly informs itself concerning the employee to be bonded. As the application blank shows, a large number

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[1] J. Frank Supplee: "Corporate Surety Bonding." Yale Insurance Lectures, pp. 277, 278.

of factors are taken into consideration in ascertaining the hazard. The applicant must furnish the company with a statement of his personal and real property holdings, his debts or liabilities and encumbrances on property, and the amount for which he is surety or indorser. Besides giving full details of the position he holds or is about to hold, the applicant must furnish particulars in case he has ever been a bankrupt, or has been discharged from a position, or has been in business for himself and has discontinued. He must name his nearest living relatives, and give the value of their personal and real estate holdings. He must furnish the names and addresses of his previous employers, the positions he has occupied, the time engaged with each, and the reasons for leaving. Lastly, he must give usually at least five references, none of whom are former employers, relatives, nor officers, or fellow employees of the service in which he is engaged. In addition to this information, the employer must furnish a statement in which is explained the past conduct of the employee, the nature of his work, the average amount of his daily cash handlings, the largest amount likely to be in his custody at any one time, and the means which are used to ascertain the correctness of his accounts.

From the foregoing information the bonding company assures itself of the character of the applicant, and the *character and financial standing of his nearest relative.* No one appreciates more than the bonding company the extent to which a father and mother will do all that can possibly be done to save a son from criminal prosecution. To quote the president of one of the companies: "The theory of the company is that when demand is made upon the company for the payment of a loss, the defaulter has exhausted all his resources and there is little hope for him. The company insists upon prosecution, but the company feels that it has no right to interfere between the employer and employee if friends come in to protect the guilty." Where the parents

are of good reputation and means, the company has a right to feel that its bond was not issued solely with reference to the employee, but that it possesses a valuable collateral in the moral indemnity of the father and mother.

In arriving at the premium on a bond, the company must be careful to ascertain the extent of its maximum liability; and for this reason requests the employer to state the average amount of daily handlings of cash by the employee, and the largest amount likely to be in his custody at any one time. While the premium is computed according to the size of the bond granted for different classes of risks, the amount of the bond that will be granted and the size of the premium per $100 of indemnity promised differ materially according to the hazard involved. It may be that a company assumes a smaller actual liability by bonding a state treasurer, who in the course of the year may have millions of dollars under his guardianship, and who may be required to furnish a bond for $500,000, than by bonding the cashier of a bank, although its liability in this case is limited to $25,000. Although the state treasurer may need a bond many times as large as the cashier, his financial operations may be surrounded by so many checks that he will have less opportunity than the cashier to steal a large sum. The bonding company may provide that there must be a counter-signature to every check, that every tax bill must be certified to by another official, that money receipts must be deposited in bank several times a day at regular intervals, that there must be frequent examinations of accounts, and that the company cannot be held liable for the loss of funds deposited in bank. Thus, although the bond is for $500,000, the company's actual liability may not exceed $30,000, because this may be the largest possible amount that the treasurer, in view of the many safeguards insisted upon by the company, has within his control at any one time.

In the case of judicial bonds also, the actual liability of

the bonding company is not indicated by the size of the bond. Executors, administrators, and receivers must frequently furnish bonds for very large amounts, in order to comply with the law of the state or the demands of the court. And yet a moment's reflection will serve to show that the size of the bond may be out of all proportion to the amount of the estate that can be wrongfully converted. Much of the estate may consist of real estate incumbered with liens which cannot be sold without first paying the debt. Another large portion of the estate may consist of stocks and bonds hypothecated with bankers as security for loans, which cannot be obtained until the loans have been repaid. Thus where a $1,000,000 estate is involved, and the administrator is required to give a bond for $500,000, a detailed examination of considerations like those just mentioned may convince the bonding company that its maximum liability could not exceed $150,000.

*Policy Provisions.*—As already stated, corporate bonds are applicable to a very wide field; and, in consequence, a large number of policy forms exist to meet special demands. These special bonds must be written in the case of contractors and administrators of estates, as distinguished from the ordinary fidelity risks. Ordinarily, when executing bonds, the company issues that form of bond which the application submitted requires. Usually bonds issued on behalf of executors, administrators, trustees, etc., are statutory (and vary slightly in different states), and the company, when executing such bonds is obliged to execute the statutory form. This applies also to bonds of federal, state, and municipal officials. In the field of fidelity risks one type of bond provides for the bonding of a number of employees specified by schedule, whereas another bonds a single individual. Again, in many instances, especially where the state or municipality is concerned, special forms of bonds are demanded by the government.

In the fidelity bond the company agrees to reimburse the employer for any pecuniary loss, not exceeding a certain specified sum, which may be sustained by reason of the dishonesty of the employee, *amounting to embezzlement or larceny*. The bond usually provides that the embezzlement must have been committed during the term of the bond, or any renewal thereof; and that it must be discovered during the term "or within three months thereafter, or within three months from the death, or dismissal, or retirement of the employee from service, within the period of this bond, whichever of these events shall happen first." The employer agrees to give immediate notice to the company of the discovery of any dishonesty on the part of the bonded employee, and to furnish full particulars within a given time. He also agrees to furnish the company with every aid and assistance possible, not pecuniary, which will help in bringing the wrongdoer to justice. In case more than one bond covers the individual in question, the company will pay the loss only in the proportion that its bond bears to the total sum of all the bonds, whether these are available or not.

Special mention is usually made in the bond of certain types of losses for which the company assumes no liability. Among these are losses resulting from mere error of judgment, or injudicious exercise of discretion on the part of the bonded employee, or from any act done or left undone by the employee in pursuance of instruction from the employer. Nor is the company liable for any loss by robbery unless the employee directly participated or connived in the same, or for any balance that the employee may owe the employer if the same has accrued prior to the date of the policy, and which may be discovered during its term. If the duties and responsibilities of the bonded employee are in any way increased and enlarged during the continuance of the bond, without the company's consent, liability for loss at once ceases, "it being the true meaning of the bond that the

FIG. 14.—Sample Form of Employer's Statement.

*Baltimore,* ______________________ *190*

______________________

______________________

______________________

*An application has been made to this Company to issue a bond of security for Mr.* ______________________ *as* ______________________ *in your service, at* ______________________, *to the amount of $* __________.

*The Company desires to have answers to the following questions, and the answers will be taken as the basis of the bond if issued.*

*Very respectfully yours,*

*President.*

| QUESTIONS. | ANSWERS. |
|---|---|
| 1. To whom is the Bond to be made payable? Give exact title. | |
| 2. From what date is it to be written, and for what amount? | ................................ 190 $.............. |
| 3. Who will pay the premium? | |
| 4. (a) How long have you known the applicant? | a. |
| (b) By whom was he referred to you? | b. |
| (c) How long has he been in your employ? | c. |
| 5. (a) What salary will he receive? | a. |
| (b) How and when will same be paid to him? | b. |
| 6. (a) What will be the title of applicant's position? | a. |
| (b) Explain fully his duties in connection therewith. | b. |
| 7. (a) If his duties embrace the custody of *cash*, state *largest* amount likely to be in his custody at any one time. | a. |
| (b) Also, the *average* amount of daily handlings. | b. |
| 8. (a) Will he be authorized to pay out, of the *cash* in his custody, any amounts on your account? | a. |
| (b) In what manner is such authority given? | b. |

[OVER.]

9. (a) If required to make deposits in bank, how often? a.

(b) In what name are deposits kept? b.

(c) Give name of depository. c.

(d) State approximate daily bank balances. d.

(e) State approximate largest bank balances at one time. e.

10. (a) Will he be authorized to sign checks on your behalf? a.

(b) Will the countersignature of any other person be invariably required; if so, whose? b.

(c) State whether he is allowed to endorse checks drawn to your order, and for what purpose? c.

(d) Is he authorized to accept drafts on your behalf? d.

11. To whom and how frequently will he account for his handling of funds and securities?

12. (a) What means will you use to ascertain whether his accounts are correct? a.

(b) How frequently will they be examined? b.

(c) If applicant is a salesman or collector, are statements rendered to customers in arrears, and at what periods? c.

(d) If applicant is an insurance agent, state period when reports and settlements are required. d.

13. When were his accounts last examined?

14. Were they at that time in every respect correct and proper securities and funds on hand to balance?

15. Is there now or has there been any shortage due you by applicant?

16. (a) Is he now in debt to you? a.

(b) If so, state amount and nature of such indebtedness? b.

17. Have you any reason to know of or suspect any previous defalcation or shortage by the applicant, or any circumstances tending to indicate that he is not a proper person to bond? If so give particulars.

18. Have you ever sustained loss through the dishonesty of anyone holding the position of the applicant?

19. If so, state what means you have adopted to prevent the recurrence of similar loss.

It is agreed that the above answers are to be taken as conditions precedent and as the basis of the said bond applied for, or any renewal or continuation of the same, or any other bond substituted in place thereof, except as specifically changed, that may be issued by THE UNITED STATES FIDELITY AND GUARANTY COMPANY to the undersigned, upon the person above named.

Dated at________________this________day of______________190

Signature of Employer____________________

If a firm, sign firm name by members thereof. If a corporation, affix corporate seal.

By____________________

________________Official Capacity.

*This form must be returned to the Home Office, Baltimore, Md., before bond will be issued.*

# FIG. 15.—Sample Form of Fidelity Application

No. ______

Please answer fully ALL questions asked below. Confidence must be reposed in the Company, if confidence is expected in return. All information is used solely by the Company in judging the risk, and will be treated as strictly confidential.

1 State your full name ______ Age ______

2 Birthplace ______ (City, state and country.) Single, Married or Widower ______

3 If a foreigner, give term and location of residence in this country ______

4 Present residence ______ (Street address, city and state)

5 Give details and values of all personal or real property you possess ______

6 Give details and amounts of any debts or liabilities you may have, and encumbrances on property ______

7 Give number and relationship of persons you entirely support ______

8 If you are surety or endorser, state amount and particulars ______

9 If ever bankrupt or insolvent state when with details of settlement made ______

10 If ever discharged from any situation or deprived of a commission or other engagement, state particulars with dates ______

11 If ever in business for yourself, give periods with particulars, also when and why discontinued ______

12 If you are now, or ever have been bonded, give particulars ______

13 If you have ever been declined a bond give particulars ______

14

| | Relationship. | Occupation. | Street address, city and state. |
|---|---|---|---|
| A ______ Name nearest living relative. | | | |
| B ______ Next nearest living relative. | | | |

15 Give value of their personal property, A ______, B ______

Give net value of their real estate, A ______, B ______

16 Give exact name of your employer desiring bond ______

17 Give main office location of said employer ______ (Street address, city and state.)

18 Describe fully character of business of said employer ______

19 State your position and duties ______

20 State your location in this position ______ (Street address, city and state.)

21 If now or previously in same service give position and term ______

22 State salary or compensation received in this employment and how paid ______

23 Give amount and particulars of any other income you have ______

24 Amount of bond herein applied for $ ______ Premium $ ______ Who pays premium? ______ (Self or employer.)

25 Give date bond is to go in force ______ If you furnish other surety or security of any kind to the above employer in addition thereto give its amount and nature ______

26 If responsible for bad credit losses in above employment, or share in profits or losses of employer's business give particulars ______

[OVER]

## Previous Employment, Etc.

APPLICANT MUST ACCOUNT, WITH PARTICULARS, FOR ANY LAPSE IN TERMS OF PREVIOUS EMPLOYMENT.

**Give names and addresses of previous employers, positions occupied, time engaged with each and reasons for leaving.**

[This data is important and replies must be full and complete. Be sure to give number of street in city addresses. If there are periods when you were unemployed please state disposition of time.]

Last employer?________________ Address? ________________

Name of party under whom you worked?________________ Address?________________

Position occupied?________, from ________________ to ________________

Where were you located when holding this postiton?________________

Reasons for leaving?________________

---

Employer prior to above?________________ Address? ________________

Name of party under whom you worked?________________ Address?________________

Position occupied? ________, from ________________ to ________________

Where were you located when holding this position?________________

Reasons for leaving?________________

---

Employer prior to above?________________ Address?________________

Name of party under whom you worked?________________ Address? ________________

Position occupied? ________, from ________________ to ________________

Where were you located when holding this position?________________

Reasons for leaving?________________

---

Employer prior to above?________________ Address? ________________

Name of party under whom you worked?________________ Address? ________________

Position occupied? ________, from ________________ to ________________

Where were you located when holding this position?________________

Reasons for leaving?________________

---

### REFERENCES.

GIVE AT LEAST FIVE. WRITE NAMES AND ADDRESSES PLAINLY.

Do not give former employers, relatives, nor officers or fellow-employe of the service in which you are engaged.

| NAMES OF REFERENCES. | OCCUPATION. | P. O. ADDRESS. |
|---|---|---|
| | | |
| | | |
| | | |
| | | |
| | | |
| | | |

I hereby declare that the above replies and statements are true and correct; and I hereby agree for myself, my heirs and administrators, in consideration of THE UNITED STATES FIDELITY AND GUARANTY COMPANY becoming surety for me, and issuing the Bond of Security hereby applied for, or any renewal thereof, or any further or other Bond or Security hereby issued by the said Company on my behalf, in my present or any other position in this service, to protect and indemnify the said Company against any loss, damage or expense that it may sustain or become liable for in consequence of such guarantee on my behalf by said Company, and forthwith after the said Company shall have paid the party or parties entitled to the same, any money under or by reason of such guarantee, to repay the said Company the amount so paid, and all other losses, costs, damages and expenses, if any, that it shall have incurred or become liable for in consequence of such guarantee. And I do further agree that the vouchers, or other evidence of payment of such loss paid by said Company to the employer under such obligation, together with vouchers or other evidence of payment of all costs and expenses whatever, incurred by said THE UNITED STATES FIDELITY AND GUARANTY COMPANY in adjusting said loss, shall be taken as conclusive evidence against me and my estate of the fact and extent of my liability under said obligations to the said THE UNITED STATES FIDELITY AND GUARANTY COMPANY.

Dated and signed at________________

this________ day of________________ 190____

In presence of

________________ Witness.

________________ Signature of Applicant.

surety shall be responsible only for moneys, securities, or property diverted from the employer through dishonesty, amounting to larceny or embezzlement on the part of the employee within the period specified in the bond while in the discharge of the duties of the office or position to which he has been elected or appointed."

In bonding contractors, the surety company usually executes its bond upon the following conditions, which are precedent to the right of recovery:

1. That the company shall not be liable for the infringement of patents, or for the validity of any letters patent concerning any patented article which the contractor by the terms of his contract agrees to furnish.

2. That the employer of the contractor performs all matters agreed to or required by the contract.

3. That if the employer of the contractor becomes informed that any claim for labor or materials arising out of the work involved in the contract remains unpaid, he will notify the company, and withhold payment from the contractor of any moneys due under the contract until such claims have been satisfied.

4. That the employer of the contractor shall immediately notify the company and furnish particulars of any changes or alterations which may be made in the plans or specification for the work mentioned in the contract; and that when such changes aggregate a certain percentage (usually 10 per cent) of the sum of the bond, no further changes shall be agreed upon, except with the consent of the surety company.

5. That the company assumes no liability for loss or damage resulting from injury to the work specified in the contract by fire, riot, earthquake, the elements, strikes or labor troubles, or any act of God.

6. That if the contractor defaults in any manner in the performance of the contract, or abandons the work he agrees

to perform, the employer of the contractor shall give immediate notice to the company, and that thereafter the company may at its option assume or sublet the contract as though no default or abandonment had taken place, all moneys payable to the contractor according to the terms of the contract or due to him at the time of default now becoming payable to the company.

## SAMPLE FORM OF FIDELITY BOND

**Whereas,** ..........................................................
..............hereinafter called the "Principal," has been appointed to the position of..........................................
..........................................in the service of

..........................................................................

..........................................................................

hereinafter called the "Obligee," and has been required to furnish a Bond for his honesty in the performance of his duties in the said position.

**And Whereas,** the Obligee has delivered to THE UNITED STATES FIDELITY AND GUARANTY COMPANY, a corporation of the State of Maryland, hereinafter called the "Surety," a statement in writing setting forth the nature and character of the office or position to which the Principal has been elected or appointed, the nature and character of his duties and responsibilities and the safeguards and checks to be used upon the Principal in the discharge of the duties of said office or position, and other matters, which statement is made a part hereof.

**Now Therefore,** In consideration of the sum of................
...................................($........), Dollars paid as a premium for the period from................................191 to..........................191 at 12 o'clock noon, and upon the faith of the said statement as aforesaid by the Obligee, and any subsequent statement or statements, all of which statements the Obligee hereby warrants to be true, it is hereby agreed and declared, that subject to the provisions and conditions herein contained, which shall be conditions precedent to the right on the part of the Obligee to recover under this Bond the Surety shall, within three months next after notice, accompanied by satisfactory proof of a loss as hereinafter mentioned has been given to

the Surety, make good and reimburse to the Obligee to the extent of the sum of.................................................... ($..........) Dollars and no further, all and any pecuniary loss sustained by the Obligee, of money, securities or other personal property in the possession of the Principal, or for the possession of which he is responsible, by any act of dishonesty on the part of said Principal in the discharge of the duties of his office or position as set forth in said statement referred to, amounting to larceny or embezzlement, and which shall have been committed during the continuance of this Bond, or any renewal thereof, and discovered during said continuance, or within six months thereafter, or within six months from the death or dismissal, or retirement of the Principal from the service of the said Obligee, within the period of this Bond, whichever of these events shall first happen.

**Sealed with Our Seals** and dated this......... day of........., 191..

**Provided** always, that said Surety shall not be liable, by virtue of this Bond, for any mere error of judgment, or injudicious exercise of discretion on the part of said Principal, in and about all, or any matters wherein he shall have been vested with discretion, either by instruction, or rules and regulations of the said Obligee. And it is expressly understood and agreed that the said Surety shall in no way be held liable hereunder to make good any loss that may accrue to the said Obligee by reason of any act, or thing done, or left undone, by said Principal, in obedience to, or in pursuance of any direction, instruction, or authorization conveyed to and received by him from said Obligee, or its duly authorized officer in its behalf; and it is expressly understood and agreed that the said Surety shall in no way be held liable hereunder, to make good any loss by robbery, or otherwise, that the said Obligee may sustain, except by direct act, or connivance of the said Principal.

**The Following Provisions** also are to be observed and binding as a part of this Bond:

**The Surety** shall be notified in writing addressed to the President of the Company, at its office, in the City of Baltimore, State of Maryland, of any act of omission, or of commission on the part of the Principal, which may involve a loss for which the Surety is responsible hereunder, immediately after the occurrence of such act shall come to the knowledge of the Obligee. That any claim

made in respect to this Bond, shall be in writing addressed to the President of the Company, as aforesaid, immediately after the discovery of any loss for which the Surety is responsible hereunder, and within six months after the expiration, or cancellation of this Bond as aforesaid. And upon the making of such claim, this Bond shall wholly cease and determine as regards any liability for any act, or omission of the Principal, committed subsequent to the making of such claim, and it shall be surrendered to the Surety on payment of such claim.

**If the Obligee** shall at any time hold concurrently with this Bond, any other Bond, or guarantee of security from, or on behalf of the Principal, the Obligee shall be entitled in the event of loss by default of the Principal, to claim hereunder only such proportion of the loss as the amount covered by this Bond bears to the whole amount of security carried, whether valid or not.

**If the Surety** shall so elect, this Bond may be canceled at any time, by giving one month's notice to the Obligee, and refunding the premium paid, less a *pro rata* part thereof, for the time said Bond shall have been in force, remaining liable for all, or any default covered by this Bond, which may have been committed by the said Principal, up to the date of such determination, and discovered and notified to the Surety, within the limit of the time hereinbefore provided for, said refund to be returned to the Surety should claim be filed within such limit of time; otherwise upon execution of this Bond, or any continuation of it, the premium paid therefor shall be deemed to have been earned for the term thereof.

**That** should the Principal become guilty of an offence covered by this Bond, the Obligee will immediately on being requested by the Surety to do so, lay information before a proper officer covering the facts and verify the same as required to by law, and furnish the Surety every aid and assistance, not pecuniary, capable of being rendered by the Obligee, his or its agents and servants, which will aid in bringing the Principal promptly to justice, and such action when required of the Obligee shall be a condition precedent to recovery under this Bond.

**The Surety** shall not be liable under this Bond for the amount of any balance that may be found due the Obligee from the Principal, and which may have accrued prior to the date hereof, and which may be discovered within the period hereof, nor shall it be liable, if at any time during the continuance of this Bond or any renewal thereof, the duties and responsibilities of the Principal

shall be increased and enlarged or the Principal shall without notice to the Surety and its written consent thereto obtained, be required or permitted to assume or discharge either temporarily or otherwise, the duties of any other office or position than that set forth and described in said statement, it being the true intent and meaning of this Bond that the Surety shall be responsible only as aforesaid, for moneys, securities, or property diverted from the Obligee through dishonesty, amounting to larceny or embezzlement as aforesaid, on the part of the Principal within the period specified in this Bond, while in the discharge of the duties of the office or position to which he has been elected or appointed.

**This Bond** will become void as to any claim for which the Surety is responsible hereunder to the Obligee, if the Obligee shall fail to notify the Surety of the occurrence of such act immediately after it shall have come to the knowledge of the Obligee. And, if without previous notice to and consent of the Surety thereto, the Obligee has intrusted or shall intrust the Principal with moneys, securities, or personal property, after having discovered any act of dishonesty, or condones any act for which the Surety may be liable hereunder, or makes any settlement with the Principal for any loss hereunder, this Bond shall be null and void, and any wilful misstatement or suppression of facts in any claim made hereunder renders this Bond void from the beginning.

**No Suit or Action** of any kind against the Surety for the recovery of any claim upon, under, or by virtue of this Bond, shall be sustainable in any Court of Law, or Equity, unless such suit or action shall be commenced, and the process served on the Surety within the term of twelve months (365 days) next, after the presentation of such claim, and in case any suit or action shall be commenced against the Surety after the expiration of the said period of twelve months, the lapse of time shall be deemed as conclusive evidence against the validity of the claim thereby so attempted to be enforced.

**If** the Obligee's written statement hereinbefore referred to, shall be found in any respect untrue, this Bond shall be void.

**The Surety** upon the execution of this Bond, shall not thereafter be responsible to the Obligee, under any Bond previously issued to the Obligee on behalf of said Principal, and upon the issuance of any Bond subsequent hereto upon said Principal in favor of said Obligee, all responsibility hereunder shall cease and determine, it being mutually understood that it is the intention of this

provision that but one (the last) Bond shall be in force at one time, unless otherwise stipulated between the Obligee and the Surety.

**This Bond** is issued on the express understanding that the Principal has not, within the knowledge of the Obligee, at any former period been a defaulter, and will be invalid and of no effect unless signed by the Principal.

**If the Obligee** be a corporation, the acts or knowledge of the President, Treasurer, Secretary, Cashier, or any officer or director of the corporation shall be the acts or knowledge of the Obligee capable of giving rise to a claim under this Bond.

**No** one of the above conditions, or the provisions contained in this Bond, shall be deemed to have been waived by or on behalf of said Surety, unless the waiver be clearly expressed in writing, over the signature of its President and Secretary, and its seal thereto affixed.

**And the Said Principal** doth hereby for himself, his heirs, executors and administrators, covenant and agree to and with the said Surety, that he will save, defend and keep harmless the said Surety, from and against all loss and damage of whatever nature or kind, and from all legal and other costs and expenses, direct or incidental, which the said Surety shall, or may, at any time sustain, or be put to (whether before or after any legal proceedings by, or against, it to recover under this Bond, and without notice to him thereof), or for, or by reason, or in consequence of the said Surety having entered into the present Bond.

**In Witness Whereof** the said Principal hath hereunto set his hand and seal, and the said Surety has caused this Bond to be sealed with its corporate seal, attested by the signature of its Attorney-in-Fact, the day and year first above written.

*Signed, sealed and delivered by the said Principal in the presence of*

............................ ............................

*Principal.*

*By*..........................

*Attorney-in-Fact.*

## FIDELITY BOND COVERING SEVERAL EMPLOYEES

**Schedule Bond No.........**

**Whereas,**.................................................... hereinafter called "The Obligee," is employing, or intends to employ, certain persons in the capacity of........................ which persons are hereinafter called "The Principals," and has filed with THE UNITED STATES FIDELITY AND GUARANTY COMPANY, hereinafter called "The Surety," a schedule specifying the amounts of security required from each Principal, and the capacity in which each is employed, and has applied to the Surety for the grant of this Bond; and,

**Whereas,** The Surety, in consideration of the sum of.......... ......................................($............) Dollars, now paid as a premium from............190 , to............190 , at 12 o'clock noon, has agreed upon the terms, provisions and conditions herein contained to issue this Bond to the Obligee; and,

**Whereas,** The Obligee has heretofore delivered to the Surety a statement in writing containing certain representations and promises relative to the duties and accounts of the Principals and other matters, it is hereby understood and agreed that those representations and such promises, and any subsequent representations or promises of the Obligee, hereafter required by or lodged with the Surety, are warranted by the Obligee to be true, and shall constitute part of the basis and consideration of the contract hereinafter expressed.

**Now, Therefore, This Bond Witnesseth,** That for the consideration of the premises the Surety shall, during the term above mentioned, or any subsequent renewal of such term, and subject to the conditions and provisions herein contained, at the expiration of three months next, after proof satisfactory to the company, as hereinafter mentioned, make good and reimburse to the said Obligee such pecuniary loss as may be sustained by the Obligee by reason of the dishonesty of any or either of the Principals named upon said Schedule, or added thereto, as hereinafter provided in connection with his duties, as specified on said Schedule, amounting to embezzlement or larceny, and which shall have been committed during the continuance of said term, or of any renewal thereof and discovered during said continuance, or within three months thereafter, or within three months from the death, or dismissal, or retirement of such Principal from the service of the Obligee, within the period of this Bond, whichever of these events

shall first happen; the Surety's liability on account of any one Principal, in no case to exceed the sum for which he shall have been specifically guaranteed, as hereinafter provided.

**Sealed** with our seals and dated this........day of........190 .

**Provided,** That on the discovery of any such dishonesty as aforesaid on the part of any Principal, the Obligee shall immediately give notice thereof to the Surety, and that full particulars of any claim made under this Bond shall be given in writing, addressed to the Surety, at its office in the City of Baltimore, within sixty days after such discovery, as aforesaid, and within three months after the expiration of this Bond; and the Surety shall be entitled to call for, at the Obligee's expense, such reasonable particulars and proofs of the correctness of such claim, and the correctness of the statements made at the time of effecting this Bond, or at any subsequent time, as may be required by the Surety, and to have the said particulars, or any of them, verified by Statutory Declaration. And any claim made under this Bond, or any renewal thereof, shall embrace only acts and defaults committed during its currency, and within twelve months next before the date of the discovery of the act or default upon which such claim is based, and upon the making of any claim, this Bond, as to the Principal, whose acts shall have caused such claim to be made, shall wholly cease and determine. And this Bond is entered into on the condition that the business of the Obligee shall be continued to be conducted and the duties and remuneration of the Principals shall remain in accordance with the statements hereinbefore referred to; and if during the continuance of this Bond any circumstance shall occur or change be made which shall have the effect of making the actual facts differ from such statement, or any of them without written notice thereof, being given to the Surety, at its office in Baltimore, and the consent and approval in writing of the Surety being obtained thereto; or if any wilful suppression or misstatement be made in any claim under this Bond, or of any fact affecting the risk of the Surety at any time, or if the Obligee shall fail to notify the Surety of the occurrence of any act of dishonesty on the part of any of the Principals as soon as it shall have come to the knowledge of the Obligee, or shall continue to intrust the Principal with money or valuable property after such discovery, then the Surety shall be discharged from any and all liability under this Bond as to such Principal.

**And Provided,** That the Obligee shall have the right at any time during the currency of this Bond, on giving notice to the

Surety at its Home Office in the City of Baltimore, or to its duly authorized agent, in writing, and receiving acceptance or consent thereto from the Surety, clearly expressed in writing over the signature of its duly authorized officer, to make interchanges or substitutions among any of the Principals as may be found necessary, and to add to the Principals of said Schedule, on payment of extra premiums therefor; such notices to set forth the names, locations, dates of appointment or change in amounts of security required of Principals so to be interchanged, substituted or added on said Schedule, and accompanied by applications from any and all Principals added with statement of the Obligee relative to their duties. And the Surety shall not be liable for other than the personal acts of the Principals within the direct scope of their duties named in said acceptance notice.

**And Provided,** That the Surety shall not be responsible under this Bond or any renewals thereof, or any Bond issued instead of such renewal, as surety, for any one Principal specified on said Schedule, for a sum exceeding the amount last written opposite his name on said Schedule, or exceeding the amount expressed in the notice from the Obligee of his appointment and not objected to by the Surety.

**And Provided,** That should the Principal become guilty of an offense covered by this Bond, the Obligee will immediately, on being requested by the surety to do so, lay information before a proper officer, covering the facts and verify the same as required by law, and furnish the Surety every aid and assistance, not pecuniary, capable of being rendered by the Obligee, his or its agents and servants, which will aid in bringing the Principal promptly to justice.

**And Provided, Also,** That if the Obligee shall at any time hold concurrently with this Bond any other Bond or security from, or on behalf of any Principal, the Obligee shall be entitled in the event of loss by default of such Principal to claim hereunder only such portion of the loss as the penalty of this Bond bears to the total penalty of all Bonds or security so held by the Obligee, whether such other security be available or not, and that any question as to the liability of the Surety to pay any claim under this Bond shall, if the Surety require it, be submitted to arbitration, the expense of which to be borne equally by the Surety and the Obligee.

**And Provided,** That if the Surety shall so elect, the guarantee of any Principal under this Bond may be canceled at any time by

notice in writing to the Obligee, and in the event of so terminating such guarantee the Surety shall, at the expiration of all liabilities hereunder, refund the premium paid, less a pro rata part thereof, for the time said Bond shall have been in force; said refund to be returned to the Surety should claim be subsequently filed within the time limit provided therefor in this Bond; otherwise upon execution of the guarantee of any Principal under this Bond, or any continuation, the premium paid therefor shall be deemed to have been earned for the term thereof.

**And Provided,** That the surety shall not be responsible under this bond, or any renewals thereof, for any one Principal included therein as specified on said schedule, or in the notices from the Obligee of his appointment where accepted by the Surety, if such Principal has at any former period been a defaulter within the knowledge of the Obligee.

**That** no suit or action of any kind against the Surety for the recovery of any claim upon, under, or by virtue of the guarantee of any Principal under this Bond shall be sustainable in any Court of Law, or Equity, unless such suit or action shall be commenced, and the process served on the Surety within the term of twelve months (365 days) next, after the presentation of such claim and in case any suit or action shall be commenced against the Surety after the expiration of the said period of twelve months, the lapse of time shall be deemed as conclusive evidence against the validity of the claim thereby so attempted to be enforced.

**If the Obligee** hereunder be a corporation, the acts or knowledge of the President, Treasurer, Secretary, Cashier, or any other officer or director of the corporation shall be the acts or knowledge of the Obligee capable of giving rise to a claim under this Bond.

**No One** of the above conditions, or the provisions contained in this Bond shall be deemed to have been waived by or on behalf of said Surety, unless the waiver be clearly expressed in writing, over the signature of its President and Secretary, or other duly authorized officer, and its seal thereto affixed.

**In Witness Whereof,** The Surety has caused this Bond to be sealed with its common and corporate seal, duly attested by its Attorney-in-Fact, this....................day of............190

THE UNITED STATES FIDELITY AND GUARANTY COMPANY,

.......................................

*Attorney-in-Fact.*

FIG. 16.—Sample Form of Contractor's Bond

**Know all Men by these Presents,** That we................

..................................................................................................................

..................................................................................................................

of ........................................................................................ as principal and the NATIONAL SURETY COMPANY, a corporation under the laws of the State of New York (hereinafter called the Company), as surety, are held and firmly bound unto

..................................................................................................................

of ........................................................................(hereinafter called the obligee) in the penal sum of.......................................................................................... Dollars ($.................) (which sum is hereby agreed to be the maximum liability hereunder) lawful money of the United States of America, well and truly to be paid, and for the payment of which we and each of us hereby bind ourselves, our heirs, executors, administrators and successors, jointly and severally, firmly by these presents.

Dated this ..........................day of ............................, 19.....

**Whereas,** said principal has entered into a certain contract in writing, bearing date ..........................., 19......, with the said obligee, ...........................

..................................................................................................................

..................................................................................................................

..................................................................................................................

..................................................................................................................

a copy of which is hereto attached, and is hereby referred to and made a part hereof.

**Now, Therefore,** the condition of this instrument is such that if the said principal shall well and truly perform the terms and provisions of said contract on the part of said principal required to be performed, then this instrument shall be null and void, otherwise to be and remain in full force and effect; *Provided, however,* and this instrument is executed by the Company as surety upon the following express conditions, which shall be precedent to the right of recovery hereunder.

1. The Company shall not be liable for the infringement of any patent, or for the validity of any letters patent granted by the United States Government concerning any patented article which is required by said contract to be furnished by said principal.

2. The obligee shall, at the times and in the manner specified in said contract, perform all the covenants, matters and things required to be by the obligee performed; and if the obligee default in the performance of any matter or thing in this instrument, or in said contract agreed or required to be performed by the obligee, the Company shall thereupon be relieved from all liability hereunder.

3. If said principal shall in any manner default in the performance of any matter or thing in said contract specified to be by said principal performed, or in the event of said principal abandoning the work provided by said contract to be done by said principal, the obligee shall immediately so notify the Company and thereafter the Company shall have the right at its option to assume and sublet said contract and to proceed thereunder as if no default or abandonment had occurred; and if the Company elect to assume said contract, all moneys agreed therein to be paid said principal and which at the time of the default be due the principal shall thereupon become payable to the Company, and shall be paid to it, anything to the contrary in said contract notwithstanding.

4. If at any time during the prosecution of the work specified in said contract to be performed there come to the notice or knowledge of the obligee the fact that any claim for labor performed or for materials or supplies furnished the said principal in or upon said work remains unpaid or that any lien or notice of lien for such work, materials or supplies has been filed or served, the obligee shall withhold payment from the principal of any moneys due or to become due to the principal under said contract until the payment of such claim or the cancellation and discharge of such lien or notice of lien, if any, and will so notify the Company, giving a statement of the particular facts and amount of each such claim, lien or notice of lien.

5. If any changes or alterations by the principal and obligee be made in the plans or specifications for the work mentioned in said contract, the obligee shall immediately so notify the Company of such changes or alterations, giving a description thereof and stating the amount of money involved by such changes or alterations. Provided, however, that when the cost of said changes or alterations shall in the aggregate amount to a sum equal to ten per cent. of the penal sum of this bond, no further changes or alterations shall be agreed upon by the principal and obligee, until the consent of the Company shall first be obtained thereto.

6. In the event of the destruction of or injury to the work specified in said contract by fire, riot, mob, the elements, earthquake, cyclone, tornado, lightning, public enemy or any act of God, or through so-called strikes or labor difficulties, neither the principal nor the Company shall be liable for any loss or damages whatsoever resulting therefrom.

7. None of the conditions or provisions contained in this instrument shall be deemed waived by the Company unless the written consent to such waiver be duly executed by its President or Vice-President and its seal be thereto affixed duly attested; nor shall this instrument or any rights thereunder be assignable unless with the like consent duly executed and attested as aforesaid.

8. No action, suit or proceeding shall be had or maintained against the Company on this instrument unless the same be brought or instituted and process served upon the Company therein within six months after the date or time fixed in said contract for the completion of the work mentioned therein.

9. All notices and other evidence required by this instrument to be furnished by the obligee to the Company shall be in writing, and shall be forwarded by registered letter addressed to the Company at its principal offices in the City of New York.

.......................................................[SEAL.]

.......................................................[SEAL.]

NATIONAL SURETY COMPANY,

By

.......................................President.

Attest:

.......................................Secretary.

FIG. 17.—Sample Form of Administrator's Bond.

# Know all Men by These Presents:

THAT WE, ______________________________

______________________________

as Principal , and NATIONAL SURETY COMPANY, a Corporation organized under the Laws of the State of New York, as Surety, are held and firmly bound unto the Commonwealth of Pennsylvania, in the sum of ______________________________

______________________________

Dollars, to be paid to the said Commonwealth: to which payment well and truly to be made, we bind ourselves, jointly and severally, for and in the whole, our heirs, executors, administrators, successors and assigns, and each and every of them, firmly by these presents.

**Sealed** with our seals. Dated the ____________ day of ____________

in the year of our Lord One Thousand Nine Hundred ____________[190 .]

**THE CONDITION OF THIS OBLIGATION IS:**

**That** if the above bounden ______________________________

______________________________

Administrat of all and singular the Goods, Chattels and Credits of

______________________________

deceased, do immediately publish for Creditors, etc., and make, or cause to be made, a true and perfect inventory and inventories according to law, of all and singular the Goods, Chattels and Credits of the said deceased, which have come, or shall come, to the hands, possession or knowledge of the said Administrat , as aforesaid, or unto the hands or possession of any other person or persons for and the same so made do exhibit, or cause to be exhibited, into the **Register's Office**, in the County of Philadelphia, within thirty days from the date hereof, and the same Goods, Chattels and Credits, and all other the Goods, Chattels and Credits of the said deceased at the time of death, which at any time after shall come to the hands or possession of the said Administrat as aforesaid, or unto the hands or possession of any other person or persons for do well and truly administer according to law And further do make or cause to be made, a just and true account of said Administration within one year of the date hereof, or when thereunto legally required. And all the rest and residue of the said Goods, Chattels and Credits, which shall be found remaining upon such Administrat account (the same being first examined and allowed by the Orphans' Court of the City and County of Philadelphia), shall deliver and pay unto such person or persons respectively as the said Orphans' Court, by their decree and sentence pursuant to law, shall limit and appoint, and shall well and truly comply with the laws of this Commonwealth relating to Collateral Inheritances. And if it shall hereafter appear that any last Will and Testament was made by the said deceased, and the same shall be approved according to law, if the said Administrat as aforesaid, being thereunto required, do surrender the said Letters of Administration into the **Register's Office** aforesaid then this obligation to be void—otherwise to be and remain in full force.

| | |
|---|---|
| SIGNED, SEALED AND DELIVERED IN THE PRESENCE OF | ____________(SEAL) |
| ____________ | ____________(SEAL) |
| ____________ | ____________(SEAL) |

[OVER]

REGISTER'S OFFICE,
CITY AND COUNTY OF PHILADELPHIA, } *ss.*

..................................A. D. 190 Then personally came the within named..................................

..........................................................................................................................................

and on....................solemn..............................did depose, declare and say, That..................... believe that the within-mentioned decedent on the ......................day of....................A. D. 190 at...........o'clock..........M, died without a will. That..........will, as the Administrat aforesaid well and truly administer the Goods, Chattels and Personal Estate, agreeably to law. That.............. will immediately publish for creditors once a week, for six consecutive weeks, and render into the Register's Office, within thirty days of this date, a just and true inventory and appraisement of the personal estate of said deceased, and additional inventories when necessary. Also, a just and true account calculating and reckoning of......................said administration in one year from this date, or when thereunto legally required. That..............................will well and truly comply with the provisions of the law relating to Collateral Inheritances. And also that..........................................................

..........................................................................................................................................

..........................................................................................................................................

And also that the whole of the Goods, Chattels, Rights and Credits of the personal estate.................. died possessed of..................................in the aggregate, do not in value exceed the sum of .......................................................................................................................... Dollars, to the best of....................knowledge and belief.

..........................and subscribed before me the day and year aforesaid, and letters of administration granted unto....................

..................................................
*Deputy Register.*

} ..................................................

..................................................

*No.*............

*Estate of* ............................ *dec'd*

*Letters of Administration*............................

*Granted*............................*A. D. 190*

# CHAPTER XXX

## TITLE INSURANCE

A TITLE-INSURANCE policy promises to protect the owner of property, or the lender of money on property, against loss or damage which he may sustain because of any defect in the title or because of its unmarketability, or because of unknown liens or incumbrances against the property at the time the policy is issued. Such policies protect only against loss arising from defects in the title which existed prior to the issuance of the policy, and do not cover defects which arose subsequent to the date in the contract. In other words, the title-insurance policy relates only to the past; it protects the title as it stands when the policy is written, and is unique among all the various types of insurance in so far that it "ends where other insurance begins, namely, at the date of the policy."

A title-insurance policy is written by the company on the theory that no known risks are assumed. Before issuing the policy, the company undertakes a careful examination of all the records and facts which may have a bearing upon the title of the premises which it is proposed to insure, with a view to discovering all defects that may exist. If any are found, they are carefully described in the policy, and then declared to be risks for which the company cannot be held liable. Title insurance thus promises to pay only those losses which result from errors made in the examination of the title from the records, or from defects which were not discovered because they were not recorded. In this connection it should be remembered that there is always a pos-

sibility that records relating to real estate may be wrongly interpreted. Lawyers may differ as to the effect which certain instruments or court proceedings will have upon the legality of a title, and their conclusions may be either imperfect or mistaken.

*The Advantages of Title Insurance.*—Title insurance is probably the least speculative of all the forms of insurance. Yet there is a sufficiently large element of risk attached to titles to make this form of insurance a convenient help to those who own or buy and sell real estate. The various advantages of this form of insurance, if issued by a reliable company, may be summarized as follows:

1. It frees the real-estate owner, or lender of money, from all worry as to possible loss because of a defective title resulting from a faulty examination of the public records. As regards the examination of the title, a title-insurance company renders all the service given by any other system, the premium including the cost of making a thorough examination, and such an examination being back of every title policy. Furthermore, because of its efficient organization and skilled employees, a large title company can give better and more reliable service than can an individual abstracter. According to law, the abstracter of a title agrees with his employer to furnish a summary of the records relating to all grants, conveyances, wills, liens, and incumbrances, judicial proceedings, mortgages, taxes, assessments, etc., which pertain to his title. The task requires skill, and the law holds the abstracter liable in case any loss results because he has not made all the necessary searches, or has not performed his work with "due care," or has certified to something which is incorrect. But the law in this respect is little more than a form; for, supposing that the abstracter is guilty of any of the above acts, how many possess the financial resources to indemnify the holder of the title for loss resulting from a serious mistake? Nor can the abstracter

be held liable for not calling the owner's attention to defects in the title which are not within the public records. A large company, with its millions of capital and surplus, on the other hand, can give assurance that if its work is not well done the owner will be indemnified for any loss he may suffer.

2. It gives security against loss resulting from errors of judgment on legal questions involved in the title.

3. It insures against loss resulting from defects which, because they are not in the public records, cannot be discovered from an examination of the same by an abstracter, such as the forgery of instruments, the making of a deed by an attorney-in-fact whose power was fabricated, or under the power of an attorney after the death of the principal, which renders it void, acts of insane persons or minors, improper probate proceedings, and failure of all parties to sign an instrument.

4. It obviates much of the loss frequently resulting from rumors affecting the validity of titles to which real estate is susceptible. Our law reports give evidence of numerous cases involving the legality of titles, and resulting in long-drawn out and expensive litigation. Title-insurance companies, however, provide in the policy that they will at their own expense "defend the insured in all actions or proceedings founded on a claim of title or incumbrance prior in date to the policy, and thereby insured against."

5. The title policy proves advantageous in so far that, unless special conditions to the contrary are inserted, it guarantees the title for all time to come. In this respect title insurance is again unique in that its term runs indefinitely into the future. The holder may assign it to subsequent purchasers or creditors, who then are protected against any loss resulting from defects in the title prior to the original date of the policy. It must be distinctly understood, however, that such purchasers are not protected against de-

fects which arise after the issuance of the policy and prior to the assignment.

6. As the term of a title-insurance policy runs indefinitely into the future, so the premium is paid but once when the policy is issued; and an assignment of the policy may thereafter be made for only a nominal fee. Although the premium may seem large, varying in the case of one company from $20 for an estate of $1,000 to $378 for an estate of $100,000, this sum is paid but once, and loses its apparent significance when spread over the long term. Moreover, it represents chiefly the cost of making an examination of the title which may necessitate the tracing of records back to Colonial days. A great variety of charges exist for this service in different sections of the country, depending chiefly upon the amount of labor involved in the examination of the records as found in the particular locality.

Realizing that the holder of a title policy may, at the request of a purchaser or mortgagee, desire a new policy, the companies are willing to grant such policies at a reduced premium. The policy usually provides that:

> "Whenever the holder of a policy of this company on his title as owner in fee or of a leasehold shall, within seven years from the date of the policy, sell or mortgage any or all of the real estate therein described, and shall within thirty days thereafter apply for a new policy on the same title, to be issued to the guarantee or mortgagee, then, if the risk be again accepted by this company, the former policy shall be surrendered and canceled, and one half of the sum paid as premiums therefor will be allowed as a deduction from the premium on the new policy."

7. As an additional protection to policy-holders, title-insurance companies are under the supervision of the several state insurance departments, and must make ample deposits with the various states in which they do business. As compared with the old system of abstracting, our modern companies give the holders of title policies the benefit of the

substantial security involved in their large capital stock and surplus and sums deposited with the insurance commissioners.

*The Manner of Examining Titles by Title-Insurance Companies.*—Originally it was customary for the owner of property who wished the title to be examined to engage someone who claimed to know how to search the records and make an abstract thereof. Then it was customary to have the abstract examined by a lawyer who was supposed to know whether or not everything was legally satisfactory. If he found the abstract satisfactory, he would give his opinion to that effect; if not, the records had to be corrected. If, in his opinion, the title was good, certification would be made to that effect on the abstract, and this opinion constituted the "certificate of title."

In modern days most of the abstracting and issuing of "certificates of title" is done by large guarantee or title companies which, in the course of time, have prepared elaborate so-called "tract systems," covering practically every piece of land in a given county or a given section of the country. These tract systems are so arranged that the title company has a classified index of the records as regards practically every tract of land within a given area. To obtain this sort of a system involves the expenditure of great labor and money. Thus the counsel for one company in the city of Los Angeles states that it would require $250,000 to construct an abstract plant which would be complete and perfect enough to be relied upon by an abstract company or the public. He explains that in his county there are 3,504 deed books, 1,922 mortgage books, and 149 miscellaneous volumes of records, and that the entire books of records aggregrate 5,800 volumes approximately. These records take into account 400 kinds of instruments.

A large title company usually has employees in the various record offices, whose duty it is to abstract briefly the

instruments as they are filed for record. Thus for deeds and mortgages they write the names of the parties, the consideration, the description of the property, the date of the record, and the book and page of the record. These abstracts, as made in a record office, are then sent over to the office of the company every hour or at frequent intervals, and are immediately turned over to certain employees who classify the same, and indicate to what property each instrument should be posted. The posting is usually done at night, so that the tract system is complete on the following day. The tract system is so organized that the company can, with the least delay, ascertain and obtain every instrument affecting the title to any specific parcel of land, if the owner should want its title examined or insured.

The manner in which the examination of a title is conducted is very fully and ably discussed by Mr. Lee C. Gates, for his own company, the Title Insurance and Trust Company of Los Angeles.[1] He explains that when an applicant desires to have his title investigated and insured he must furnish the description of the property on the customary application blank. This description of the property is then sent to the "searching department," where it is assigned to a "chainmaker." This chainmaker examines the company's tract system, which contains the account of the property upon which the search is desired. From the book before him he inserts upon proper blanks the names of the parties, the grantor and grantee, mortgagor and mortgagee, the date of record, the instrument to be examined, and the book and the page of the record. In other words, he makes out the "chain of title."

When all the instruments affecting the title to the property have been noted, the chainmaker's chain of title is handed over to the "searcher," who goes over the books with

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[1] Proceedings of the second annual meeting of the American Association of Titlemen, p. 114 and following.

a view to rechecking the work of the chainmaker, and makes sure that all the instruments affecting the title to the property in question have been accounted for, and proper blanks provided for their abstracting. Having completed the rechecking he proceeds to the office where the original records are kept, and examines each record, making note of anything he deems necessary in order to complete his abstract of title to that particular property. When all the records have been examined, the searcher writes his conclusion as to the condition of the title which he has examined.

After the search has been completed, and the searcher's opinion written, his work is next submitted to the "examiners," usually a body of selected lawyers who take up the title from the beginning, examine the abstract, go over each separate instrument with a view to noting defects or imperfections, and finally review the opinion as written by the searcher. If necessary, this certificate is revised or remodeled. It is then signed by the officers of the company and becomes a "certificate of title." Briefly stated, it usually reads as follows: "That after a careful examination of the official records of the county of............, made at the request of the owner or purchaser, the title-insurance company certifies that the title, as it appears from said record, is vested in John Smith, free of all incumbrances, except (1) taxes of —— (2) a mortgage; and (3) a mechanic's lien."

A title-insurance policy can then be written, which is based upon this certificate of title, and which fully protects the owner of the property against loss resulting from any error that may have been made in the examination of the title, or from any defect which may be outside of the records. It should be stated here that title-insurance companies also usually have a law department which examines all law and court proceedings affecting titles, and which advises the searching and the examining departments.

*The Losses Paid by Title Companies.*—As stated, title insurance is based upon the theory that no insurance is granted against known defects, and that the companies write such policies on the assumption that the examination has been made so carefully that in all probability no loss will arise under the policy. The reports of various title-insurance companies show that the losses paid are trivial when compared with the total amount of business done. About one-half of the title-insurance companies reporting to the state insurance departments show no losses whatsoever during most years, and even the very largest companies have only trivial losses. Thus the Lawyer's Title Insurance and Trust Company of New York, which reports an annual premium income of $1,510,000, shows losses which range from a minimum of $19,776, in 1903, to a maximum of $33,906, in 1904. In 1908, the loss amounted to only $22,000. In its twenty-one years of existence, this company has suffered aggregate losses only slightly in excess of $150,000. Similarly, the Title Insurance and Trust Company of Los Angeles, which in 1908 had a premium income of $290,715, showed losses of only $715. As regards nearly all the other companies, the losses per year seldom amount to more than $1,000.

*Types of Policies.*—Title-insurance policies differ greatly in their terms, owing partly to the difference in conditions prevailing in different localities, but chiefly to the desire of policy-holders for special forms to meet special conditions. As Mr. William C. Niblack explains in his "Abstracters of Title Insurance":

"Each title company has its own forms of contract. Some contracts merely guarantee the correctness of the certificate of title; some 'certify and guarantee' that the insured has a certain interest in the title; some insure that the title to the property is marketable and merchantable, while others expressly declare that the company shall not be liable in any event for loss arising from

the refusal of any person to carry out any contract to purchase, lease, or loan money on the title; some fix a maximum amount of indemnity which may be recovered, and others guarantee the title generally. In some policies the duration of the contract is limited to a certain number of years. Some contracts provide that, on notice, the company will at its own cost defend any legal action in which the title prior to the date of the policy is attacked. Some companies issue different forms of policies at different rates of compensation."[1]

Despite the many varying provisions which are incorporated in order to make title-insurance policies conform to special conditions, such policies may be, broadly speaking, divided into two main classes, viz., "fee policies" and "mortgage policies." In describing these two types of policies, Mr. Niblack explains that:

"As to fee policies, the owner is insured in his own title; the purchaser is insured in the title of his vendor at the date of the purchase; there is a form for insuring a corporation and its successors instead of an individual, his heirs, and devisees; there is a form for insuring the purchaser at a judicial sale when there is a period of redemption from such sale. As to the mortgage policies, one form insures the mortgagee; where a trust deed is used to secure the debt, one form insures the trustee named in it, for the use and benefit of the owner of the indebtedness, and another insures the owner of the indebtedness secured by the trust deed, either by name or by the general description."[2]

An essential difference exists between fee and mortgage policies with reference to the application on the basis of which the policy is issued. As regards the fee policy, it is usually provided that the statements in the owner's application are correct and true to the best of the applicant's knowledge, and that any false statement or suppression of material information will void the policy. In the case of a mortgage policy, however, it would seem unjust to bind the mortgagee

[1] William C. Niblack, "Abstracters of Title Insurance," p. 162.
[2] Ibid., p. 163.

by the mortgagor's statement of facts. The mortgagee is interested in the property as regards its value as security, and cannot be presumed to have knowledge of the validity of the title. To be sure, his welfare as lender will depend upon the validity of the title, and consequently of the mortgage; and for that reason he may request the borrower to furnish him with a policy protecting him against contingencies. In obtaining the policy, the mortgagor will be asked to answer the questions set forth in the application; but for the protection of the mortgagee, the policy either does not refer to the application, or it is merely agreed in the application "that the statements are correct and true to the best of the applicant's knowledge or belief."

*Provisions of the Policy.*—As pointed out, a great variety of title policies are written to suit the demands of the public. But in outlining the main provisions of the contract, we will take under consideration a general policy. Such a policy agrees "that in consideration of the payment of its charges for the examination of title, the company will insure................his executors, administrators, heirs, or devisees, and all other persons to whom this policy may be transferred with the assent of this company, testified by the signature of the proper officer of this company indorsed on this policy, against all loss or damage not exceeding ........................dollars, which the insured shall sustain by reason of any defect of the title of the insured to the estate or interest described in "Schedule A" hereto annexed, affecting the premises described in said schedule, or by reason of the unmarketability of the title of the insured described in said schedule to or in said premises, or because of liens or incumbrances against the same at the date of this policy; excepting the defects, estates, objections, liens, or incumbrances mentioned in Schedule B, or excepted by the conditions of this policy, hereto annexed, and hereby incorporated into this contract." In this policy the company, of

course, assumes no known risks, or risks for which the insured is personally responsible. Consequently, such policies exempt the company from all losses which may be due to judgments against the insured, or defects, objections, liens, or incumbrances granted by the act or with the knowledge of the assured. Furthermore, the company exempts itself from all claims which may result from any defects or incumbrances which are mentioned in the policy itself. Considerable blank space is provided in the policy, usually under the caption "Schedule B," where all such known defects are enumerated.

The policy also provides that the company will, at its own cost, defend the insured in all actions or proceedings which are founded on a claim of title or incumbrance prior in date to the policy, but no claim is to be paid under the policy except:

1. In all cases where a final judgment has been rendered in a court of competent jurisdiction which results in the dispossession or eviction of the insured from the premises covered by a policy, or from some part or undivided share or interest therein.

2. Where an adverse final judgment has been rendered in a court of competent jurisdiction upon a lien or incumbrance not excepted in the policy.

3. Where the insured has contracted in writing to sell the estate or interest covered by the policy, and the title has been rejected because of a defect or incumbrance, not excepted by the policy. In such cases where notice of the rejection is furnished to the company, usually within ten days thereafter, the company may exercise the option of either paying the loss or maintaining some proper action in the name of the insured at its own cost, the company, however, not to be liable until final judgment is rendered in the suit.

4. Where the interest of a mortgagee has been insured,

and on foreclosure of the mortgage the same is adjudged to be a lien inferior to that designated in the policy.

5. Where the insured has negotiated a loan on the security of a mortgage on the insured estate or interest and the lender rejects the title because of some defect or objection not excepted in the policy. In such cases the company agrees to submit the question of the validity of the title at its own expense to the proper judicial tribunal, and agrees that its liability shall depend upon the judgment of that court.

6. Where the insured has transferred the insured title by an instrument containing covenants in regard to the title, and a final judgment is rendered against the insured on any of such covenants because of a defect in the title covered by the policy.

Relative to the payment of losses, title policies generally provide that the company will pay the expenses of litigation, including any costs recovered against the insured, in addition to the loss. The company, however, reserves the right to appeal from any judgment which fixes its liability. Losses will be paid within thirty days after written notice of the loss unless the company, within the thirty days, elects to take an appeal from a judgment adverse to the insured title, in which case the loss shall not be payable until the final determination of the suit. The company, however, is willing to pay losses prior to the final determination of the suit, provided the insured will either give satisfactory security to the company for the repayment of the amount of loss paid by it in case the company ultimately wins the suit, or consents to convey the insured estate to the company, or to some other purchaser named by it, at the price at which the insured has contracted to sell the property (if such contract has been made), or at the option of the company, at a valuation of the insured estate or interest as made by three arbitrators.

*Mortgage Policies Guaranteeing the Principal and Interest on Mortgages.*—It is becoming the practice of a number of large mortgage companies to sell mortgages to investors which are insured against loss of interest, principal, and title. In most instances the title of the property which secures the mortgage is insured by a title-insurance company, and the mortgage is then sold and insured as to principal and interest by a subsidiary company. Generally, the mortgage company adheres to certain limitations, which aim to safeguard its business. Not only do these companies render expert service in placing the mortgages on property which will amply secure them, but the total outstanding guaranteed mortgages are limited to twenty times the capital and surplus of the company. To make this limitation practically irrevocable, such companies usually provide in their by-laws that the limitation is "not to be amended or repealed except with the written consent, duly acknowledged, of the owners of all the policies of mortgage insurance then outstanding and issued by the company." It may be added that this is the standard generally accepted in Europe by this class of companies. Furthermore, the loans of the company are limited to a certain definite territory, and to certain designated income-producing business or residence properties.

In the case, for instance, of the Lawyers' Mortgage Company, all guaranteed mortgages are taken through the Lawyers' Title Insurance and Trust Company of New York, with a capital, surplus, and undivided profits of $10,000,000, which guarantees the title, the identity of the property, and the genuineness of the signatures, thus protecting the mortgage company against bad titles, false descriptions, or forged papers. The profits of the Mortgage Company are limited to one-half per cent, the difference between the one-half per cent retained by the company, and the interest paid by the borrower being received by the investor. In return for this one-half per cent, the company acts as an agent of the mort-

gagee for the collection of interest. It will also look after the fire insurance, the payment of taxes and assessments, and all other matters which the mortgagor should attend to. The company also protects the mortgagee with a mortgage policy, which provides for the payment of interest the day it is due, and for the payment of the principal of the mortgage at maturity after collection from the mortgagor; or, in any event, within eighteen months after maturity, the regular semi-annual interest being paid meanwhile. The policy usually contains no exceptions as to loss resulting from fire, riot, tornado, earthquake, defects in title, or any other cause. When the guaranteed mortgage is purchased, the investor receives the bond, the mortgage, the guaranteed policy of the company; and, if desired, the title policy of the title-insurance company. The fire-insurance policies are, for the sake of convenience, retained in the office of the company.

Judging from a recent semi-annual report of one of the largest mortgage companies in New York, with a capital and surplus of $26,000,000, such mortgages, insured as to interest, principal, and title, furnish a very safe and profitable investment. Within a period of six months during 1909, this company sold nearly $17,000,000 worth of mortgages, over $2,000,000 netting the mortgagee 4 per cent, nearly $14,000,000 netting 4½ per cent, and over $1,000,000 netting 5 per cent.

The distribution of these mortgages by customers is interesting, since it appears that savings banks took $2,232,-000 worth out of the $17,000,000; trustees, $5,552,000; charitable institutions, $2,289,000; insurance companies, $1,372,000; trust companies, $272,000; and individuals $5,178,000. Since its beginning, in 1894, this company has made approximately 10,000 loans, aggregating $155,000,000. Out of this entire number the company has been compelled to purchase only eighteen at foreclosure sale, amounting to only $424,000, and resulting in a total loss of only $13,000.

Not only is the holder of the mortgage protected because of the expert service which is given him in selecting the security back of the mortgage, but, because of the large assets of the mortgage company or the title-insurance company, as

## APPLICATION FOR INSURANCE OF TITLE.

*Louisville, Ky.* ______________ *190*___

*The undersigned hereby applies to the* **LOUISVILLE TITLE COMPANY** *for a policy of insurance, in its usual form, in the sum of $*__________, **which is the true consideration for the interest to be insured,** *on the title to the premises hereinafter described, hereby covenanting that the following statements are true and correct to the best of the applicant's knowledge and belief, and that if before the delivery of the policy to be based hereon he should have any further information or any intimation as to any defect of title, objection, lien or incumbrance affecting said premises or any part thereof, he will at once make the same known to this Company. Applicant further agrees that any untrue statement herein, or any suppression of material information, or any failure to communicate any such information or intimation shall avoid the said policy.*

Description of premises: ______________

Person to whom the policy is to be issued. ______________

Interest to be insured: ______________

Present owner of property: ______________

How title of present owner acquired. ______________

Person in possession of property. ______________

By what title is such possession held. ______________

Are there any unpaid taxes or assessments, mortgages, liens or other incumbrances on the property? ______________

If any, which are to remain? ______________

Does any other property drain over or under the property described herein? ______________

Does any person other than the present owner use or claim any right to use any portion of the premises for **any purpose?** ______________

Are there any buildings or repairs now being made or any other work now being done on the premises? ______________

Do you know or have you heard of any objection to the title? ______________

By whom, and for whom was the title last examined? ______________

Are there any unrecorded deeds or agreements, or any adverse claims or interests, or any secret trusts, known or rumored to exist? ______________

Shall a survey of the property be made? It is understood that unless a survey is ordered the Company will not be responsible for adverse possession of any part of the premises by others than the present owner, or for any deficiency of land or for any easements or licenses therein not disclosed by the records affecting the title. The fee charged for the survey is in addition to the fee charged for the policy. Charge $

It is understood that where the title is insured any delay or expense in obtaining actual possession of the premises is to be borne wholly by the insured and not by this Company.

Applicant hereby agrees to pay the Company for such policy $__________; and if the Company declines to insure the title as herein applied for, to pay for its time and expense in the investigation of the title, $__________. Provided, however, that notwithstanding the rejection for insurance, if applicant shall accept the title or shall receive a complete written statement of its condition, applicant agrees to pay the full fee first named in this clause. It is understood that any investigation made under this application is made for the Company's information, and not as agent for the applicant.

**How is consideration to be paid? If already paid, how was it paid?** ______________

*Witness:* ______________

*No.* __________ *Address* ______________

FIG. 18.

the case may be, he is protected against loss through any defect in the title of the property, or through failure on the part of the borrower to pay interest and return the principal.

## SAMPLE FORM OF TITLE INSURANCE POLICY

Policy No. Title No.

LAWYERS TITLE INSURANCE AND TRUST COMPANY

**This Policy of Insurance Witnesseth:** That the LAWYERS TITLE INSURANCE AND TRUST COMPANY in consideration of its premium in dollars to it paid doth hereby insure and covenant that it will keep harmless and indemnify....................
..............................................................
(hereinafter termed the assured),......................executors, administrators, heirs, and devisees, and all other persons to whom this policy may be transferred with the assent of this company, testified by the signature of the proper officer of this company, indorsed on this policy, against all loss or damage not exceeding..................................................... dollars, which the said assured shall sustain by reason of defects, or unmarketability of the title of the assured to the estate, mortgage or interest described in Schedule "A," hereto annexed, or because of liens or incumbrances charging the same at the date of this policy, **Excepting** judgments against the assured and estates, defects, objections, liens, or incumbrances, created by the act or with the privity of the assured, or mentioned in Schedule "B," or excepted by the conditions of this policy hereto annexed and hereby incorporated into this contract. **The loss and** the amount to be ascertained in the manner provided in the annexed conditions and to be payable upon compliance by the assured, with the stipulations of said conditions and not otherwise. If this policy be one issued to an owner, and only in that case, any loss hereunder may be applied by this company to the payment of any mortgage mentioned in Schedule "B," or to the payment of any purchase money mortgage, given by the assured, where such mortgage is held by this company, or by an assured of this company. The payment so made shall be deemed a payment under this policy. **This Policy** is issued upon application, Number..... made on behalf of the assured.................................. Examining Counsel of the company.

**In Witness Whereof,** The corporate seal of the said company is hereunto affixed this................day of................in the year of our Lord one thousand nine hundred and

..................................*President.*

..................................*Secretary.*

**Schedule "A":** Showing

*First.* The Estate or Interest of the Assured covered by this Policy.

As mortgagee under the mortgage hereinafter set forth.

*Second.* The description of the Property, the Title to which is insured.

*Third.* The Deed or other means by which Title is vested in the assured.

Mortgage made by........................................
to the assured, to secure $...........dated...........and recorded in the office of the Register of the County of New York in Liber ........, Section........of Mortgages, at page..................

**Schedule "B":** Showing estates, defects, or objections to title and liens, charges or incumbrances thereon, which do or may now exist, against which the Company **Does not** agree to insure or indemnify.

## Conditions of this Policy:

**The Company** will, at its own cost, defend the assured in all actions or proceedings founded on a claim of title or incumbrance prior in date to this policy and thereby insured against.

**No Claim** shall arise under this policy except in the following cases:

I. Where there has been a final judgment rendered in a court of competent jurisdiction, under which the assured may be dispossessed or evicted from the premises covered by this policy or from some part or undivided share or interest therein.

II. Where there has been a final judgment in such a court upon a lien or incumbrance not excepted in this policy.

III. Where the assured shall have contracted in writing to sell the insured estate or interest, and the title has been rejected because of some defect or incumbrance not excepted in this policy, and notice in writing of such rejection shall have been given to the company within ten days thereafter. The company shall in that case have the option of paying the loss or of maintaining some proper action or proceeding in the name of the assured, but at its own cost, against the vendee for the purpose of determining the validity of the objection alleged by him, and only in case final judgment is rendered in such action sustaining the objection shall this company be liable on this policy; provided, however, that if a suit shall have been commenced subsequent to the date of this policy, claiming some interest in the property insured, or to establish or enforce some lien thereon, against which interest or lien the holder of this policy is hereby insured, this company shall not be liable for any loss growing out of such rejection of title, unless and until final judgment is rendered in such suit adverse to the title hereby insured.

IV. Where, in cases of insurance on the interest of a mortgagee, on foreclosure of the mortgage, the same has been adjudged to be a lien inferior to that designated in this policy; or where, in such a case, the purchaser under the judgment in the action has been relieved by the court from his purchase by reason of the existence of some defect in the title or of some incumbrance thereon not excepted in this policy.

V. Where the assured shall have negotiated a loan on the security of a mortgage on the insured estate or interest, and the title shall have been rejected by the proposed lender. In such case, this company, if there is no dispute as to the facts, will consent to the submission of the question of the validity of the title as insured, at its own expense, to the Appellate Division of the Supreme Court in the Judicial Department in which is situated the property affected by this policy, and upon the judgment of that court in such action shall depend the liability of the company.

VI. Where the assured shall have transferred the title insured by an instrument containing covenants in regard to title or warranty thereof and there has been a final judgment rendered in a court of competent jurisdiction against the assured, his heirs, executors or administrators, on any of such covenants or warranty

and because of some defect of title or incumbrance against which the holder of this policy is hereby insured.

But in each and every case enumerated above, the company shall not be liable unless the assured shall have given notice to it in writing of the commencement of any action or other proceeding upon the judgment in which the company's liability may depend, and the company shall have been allowed, to prosecute or defend such action or proceeding as the case may require. Where the action is such as does not necessarily involve the validity of the title insured, notice shall be given to the company within ten days, after the service of any paper or pleading, the object or result of which shall be to call in question the validity of the title, and the company shall have the right to prosecute or defend in such case as above provided.

In all cases where an action or other proceeding is brought or defended as above mentioned, the company will pay the expense of the litigation including any costs recovered against the assured in addition to the amount of the loss. But in no case will the company be liable for the fees of counsel or attorney employed by the assured. In all cases the right of the company to appeal from the judgment fixing its liability must be preserved and secured to it although the loss may not yet have been paid or the amount of the claim determined; but any appeal taken by the company shall not operate to delay the payment of the loss beyond the time when it would otherwise have been payable under the terms of this contract.

Every loss shall be payable within thirty days after written notice of loss to the company and presentation of proper proofs thereof, except that where the company within the said thirty days shall elect to take an appeal from a judgment adverse to the title, the loss shall not be payable until the final determination of the suit or as hereinafter provided, unless the assured shall give to the company satisfactory security for the repayment to the company of the amount of loss paid by it in case the suit shall ultimately be determined in favor of the company, or unless the assured shall consent to convey the insured estate to the company, or to some other purchaser named by it at the price at which the assured shall have contracted to sell it (if such contract shall have been made), or at the option of the company, at a valuation of the insured estate or interest to be made by three arbitrators or any two of them, one to be chosen by the assured and one by the company and the two thus chosen to select an umpire, and no right of

action shall accrue until notice of such valuation shall have been served upon the company, and until thirty days after the assured shall have tendered a conveyance of the insured estate or interest to a purchaser to be named by the company at such valuation or at the price at which the assured shall have so contracted to sell the property, less in any case the amount of any incumbrance on said insured estate or interest not hereby insured against, and the company shall have failed within that time to find a purchaser for the estate upon such terms; provided, however, that in cases of insurance on the interest of a mortgagee when the company shall elect to take an appeal from a judgment in foreclosure of the mortgage which shall adjudge the same to be a lien inferior to that stated in this policy, or from any order in such action relieving the purchaser from his purchase by reason of the existence of some defect in the title, or of some incumbrance thereon not excepted in this policy, then upon the expiration of two years from the entry of such order or judgment, or upon the affirmance of such order or judgment by the Appellate Division (whichever shall first happen) the assured shall have the right to require the company, within thirty days after demand, to pay the amount due upon the mortgage and the costs and disbursements in the action upon its receiving a proper assignment of the mortgage and of all the rights of the assured under the judgment: provided that no liability on the part of the company shall exist to take such assignment unless the market value of the property described in the mortgage at the time of such demand shall after deducting the amount of any unpaid taxes and assessments thereon be at least 50 per cent more than the amount of the mortgage and provided further that no liability on the part of the company shall exist to take such assignment merely upon the lapse of said period of two years, unless the prosecution or defense of such action, if by counsel of the assured, shall have been conducted with all due diligence.

If the assured shall within seven years from the date of this policy sell or mortgage the property, the title to which is insured hereby, then upon application of an examining or associate examining counsel made within thirty days after such sale or mortgage and approved by the company for a new insurance on the same title to be issued to the grantee or mortgagee and upon the consent in writing of the assured, and the surrender and cancellation of this policy a new policy or policies shall be issued, and four fifths of the sum paid as premium for this policy will be allowed as a deduction from the premium on such new policy or policies.

A fee of two dollars and fifty cents shall be payable for each new policy. No further policy will be issued upon a subsequent sale or mortgage except on such terms as the company may fix.

When a policy of insurance is issued to a mortgagee, all liability of the company to the assured shall cease upon the foreclosure of the mortgage, unless the assured, having become the owner by purchase under such foreclosure, shall, within thirty days from the delivery of the deed thereunder, apply to be insured as owner, stating in such application whether to his knowledge the title to the premises has been disputed or questioned.

Upon such application the company shall have the option either to issue insurance to the owner subject to any estates, defects, objections, liens or incumbrances since the date of the mortgagee policy, for the same amount written therein, allowing as a rebate from the premium for such owner's policy the full amount of the premium paid on said mortgagee policy or to purchase the property for the amount due the mortgagee for principal, interest, fire-insurance premiums, costs and disbursements under the decree of foreclosure and sale, together with the amount of any taxes, assessments and water rates which may have been paid by such purchaser to complete his title under the foreclosure sale.

Policies of insurance, issued as collateral security to mortgagees or others interested only as creditors in the title insured, may be transferred to assignees of the mortgage or indebtedness upon payment to the company of one dollar for each transfer, but no transfer shall be valid until it shall have been approved by the company, and such approval may be refused if not applied for within thirty days after the conveyance or assignment of the interest insured.

All interest in this policy, saving that for damages accrued, shall cease by the transfer of this policy except as herein otherwise provided.

All payments under this policy shall reduce the amount of the insurance *pro tanto*, and no payment can be demanded without producing this policy for the indorsement of such payment. If the policy is lost, indemnity must be furnished to the satisfaction of the company.

Whenever the Company shall have settled a claim under this policy, it shall be entitled to all the claims and rights which the assured has in the estate or interest insured, against any other person or property, or would have had against any person or property, had this policy not been made. The assured agrees to trans-

fer to the company such rights and to permit it to use the name of the assured for the recovery or defense thereof. If the payments do not cover the loss of the assured, the company shall be interested in such rights or claims with the assured in the proportion of the amount paid to the amount of the loss not covered thereby. The assured warrants that such rights of subrogation shall vest in the company unaffected by any act of his. In all cases where the company is called upon to pay the full amount insured by this policy, it shall have the right to purchase the insured estate at an appraised value to be ascertained by arbitrators as above provided.

*Approved*

For value received,.............assign the within policy to

Dated.........................................191

Witness:.........................................

*Approved*

For value received,.............assign the within policy to

Dated.........................................191

Witness:.........................................

*Approved*

For value received,.............assign the within policy to

Dated.........................................191

Witness:.........................................

*Approved*

For value received,.............assign the within policy to

Dated.........................................191

Witness:.........................................

# CHAPTER XXXI

## CREDIT INSURANCE

Credit insurance may be defined as that form of insurance which seeks to indemnify extraordinary losses in credits suffered by manufacturers, wholesalers, and jobbers through the insolvency of their customers. It is essential to bear in mind that this form of insurance does not insure against the expected losses occurring in any business, but covers only the unexpected losses, i.e., those in excess of the average loss.

This form of insurance may be regarded as scarcely out of the experimental stage. Thus far the companies have lacked the extensive statistical data necessary to place any system of insurance upon a scientific basis. In fire insurance we have seen that risks are carefully classified, and that full records of losses exist, which serve as a guide in the charging of premiums. But in credit insurance no such attempt has been made to reduce the underwriting of risks to a scientific basis, and the companies are obliged at present to issue their policies on the policy-holder's own statement as to the losses he has suffered for the last few years. Whereas fire-insurance premiums have shown a tendency to decrease during the last few decades, the rates in credit insurance have shown a tendency to rise; until in some instances they are nearly twice as high as formerly.

But whatever may be the difficulty under which credit insurance is laboring, it must be conceded that there is need for this type of insurance. Every merchant concedes the necessity of carrying fire insurance on his stock, yet the total sales of every merchant each year—sales made largely

on the basis of credit—exceed the value of his stock on hand by many times. Statistics also show that the annual loss of credits in the United States by insolvency of debtors exceeds the total fire loss. The following table comparing the annual fire loss with the insolvency loss, as compiled by Bradstreet's, makes an interesting showing:[1]

| Year. | Fire. | Failure Liabilities. |
|---|---|---|
| 1907 | $215,671,250 | $383,711,658 |
| 1906[2] | 459,710,000 | 127,173,492 |
| 1905 | 175,193,800 | 121,771,942 |
| 1904[3] | 252,554,050 | 143,648,351 |
| 1903 | 156,195,700 | 154,277,093 |
| 1902 | 149,260,850 | 105,693,623 |
| 1901 | 164,347,450 | 129,978,838 |
| 1900 | 163,362,250 | 127,184,705 |
| 1899 | 136,773,200 | 119,730,593 |
| 1898 | 119,650,500 | 141,137,115 |
| 1897 | 110,319,650 | 156,100,000 |
| 1896 | 115,655,500 | 247,000,000 |
| 1895 | 129,839,700 | 158,800,000 |
| 1894 | 128,246,400 | 149,500,000 |
| 1893 | 156,445,875 | 402,500,000 |
| Totals | $2,633,226,175 | $2,668,207,410 |

The foregoing table clearly demonstrates that losses through insolvency are not only very large, but that they vary greatly from the average loss, especially in panic years. A further analysis of commercial failures shows that a very large proportion of the loss is traceable to causes, such as disasters, which could not be foreseen. A classification of the failures in the United States during 1907 by causes shows the following:[4]

[1] "Collateral on Merchandise Accounts," issued by The American Credit Indemnity Company of New York, p. 19.

[2] The year of the San Francisco disaster.

[3] The Baltimore fire occurred this year.

[4] "Collateral on Merchandise Accounts," issued by the American Credit Indemnity Company of New York, p. 20.

## DUE TO FAULTS OF THOSE FAILING

| | Number. | Liabilities. |
|---|---|---|
| 1. Incompetence (irrespective of other causes).... | 22.6% | 8.9% |
| 2. Inexperience (without other incompetence).... | 4.9% | 3.2% |
| 3. Lack of capital.................................. | 37.1% | 18.4% |
| 4. Unwise granting of credits.................... | 2.3% | 3.1% |
| 5. Speculation (outside regular business)......... | 0.7% | 4.9% |
| 6. Neglect of business (due to doubtful habits)... | 2.5% | 0.5% |
| 7. Personal extravagance........................... | 0.9% | 0.5% |
| 8. Fraudulent disposition of property............. | 10.1% | 5.1% |
| Totals.............................................. | 81.1% | 44.6% |

## NOT DUE TO FAULTS OF THOSE FAILING

| | Number. | Liabilities. |
|---|---|---|
| 9. Specific conditions (disaster, etc.)............. | 16.3% | 51.7% |
| 10. Failure of others (of apparently solvent debtors) | 1.4% | 3.3% |
| 11. Special or undue competition.................... | 1.2% | 0.4% |
| Totals.............................................. | 18.9% | 55.4% |

It is clear that in the granting of credit to purchasers by manufacturers, wholesalers, and jobbers, there is a sufficient uncertainty in the loss from year to year, and a sufficient lack of control over the causes which underlie those losses to make the granting of credit a fit subject for insurance. In promising indemnity for loss of credits, credit insurance benefits the insured by giving him "substantial collateral on every merchandise account." It insures him against the loss of his profits, because, when he sells on credit, the price includes his profit as well as the cost of production. In fact, credit insurance differs from fire insurance in two important respects, viz., that it insures against the loss of profits, and that it covers the insured's interest in goods after they have left his possession. Lastly, the credit-insurance policy can serve as a conservative guide in the extension of credit to customers. The credit bond, as has been said, "is valued and respected by both the credit and sales depart-

ments, and consequently tends to induce perfect harmony between the two by arbitrating differences of opinion as to the line of credit to be extended to any customer. Its influence in this capacity is beneficial in any business."[1]

*Methods of Safeguarding the Company Against Unnecessary Losses.*—Credit-insurance companies must carefully restrict the risk which they assume, because the giving of unlimited protection against loss from bad debts would greatly increase the recklessness with which credit would be extended. The object of credit insurance is merely to indemnify losses which cannot be foreseen, and which are not brought about by the deliberate carelessness of the insured. To prevent recklessness on the part of the insured, all credit-insurance policies contain at least six provisions which define the extent of the company's liability. They are as follows:

1. *The Initial Loss.*—Every credit-insurance policy provides that the insured must first himself bear the so-called "initial loss" or "own loss" before the company becomes liable for the excess. This initial loss represents the annual expected or "normal loss" which the business has experienced over a period of years. As shown by the application blank this average or expected loss is determined by comparing the net losses to the gross sales of the business for the last five or six years. The average loss, since it is expected to occur, may be viewed as a part of the cost of operating the business. It is not considered a fit subject for insurance, since it can be easily shifted to the consumer in the form of higher prices.

In the policy, the "initial loss" is expressed in the form of a percentage of the gross sales. It differs for nearly every type of business, and even differs for different firms in the same line of business. Conditions are seldom alike, and

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[1] "Collateral on Merchandise Accounts," p. 13.

one type of business suffers much more from loss through bad debts than another. Again, in a given line of business, one man may make his terms of sale very different from another. He may confine his sales to a particular territory, or he may cater to the trade of, a particular class, or his credit department may be liberal instead of conservative. Furthermore, the initial loss provided against in the policy increases as the sales of the business grow. Thus, if we assume the sales of a prospective applicant for credit insurance to equal $100,000, and the initial or expected loss arranged for in the policy to be 1 per cent of these sales, then the insured must suffer a loss of $1,000 before the company can be called upon to pay any excess. In case, however, the business conditions are prosperous and the sales for the year increase to $150,000, then the initial loss, fixed at 1 per cent, will automatically increase to $1,500. But, on the other hand, the initial loss is limited in the policy to a stipulated minimum, say $1,000, and will not decrease if, because of poor business conditions, the sales fall below $100,000. This is due to the well-recognized fact that decreased sales are indicative of business conditions which tend to increase the danger of loss through bad collections.

2. *Coverage.*—But a credit-insurance company does not even promise to pay all losses over and above the initial loss, because if no other restriction be made, an unusually large amount of credit may be recklessly granted to a single customer, thus destroying the application of the law of average to this form of insurance. To avoid this possibility the policy provides for a "coverage agreement," according to which the insured is promised protection for only an agreed percentage of any one customer's capital rating, i.e., a certain percentage of the financial worth of the customer as furnished by some leading mercantile agency. The insured is given the option of selecting either Bradstreet's or Dun's as the mercantile agency whose rating he wishes to have

used as the basis of the coverage agreement. Since the rating systems of Bradstreet's and Dun's perform such a vital service in the granting of credit insurance, the system of one of these mercantile agencies is here presented:

R. G. DUN & CO.[1]

| Estimated Pecuniary Strength. | | General Credit. | | | |
|---|---|---|---|---|---|
| | | High. | Good. | Fair. | Limited. |
| AA | Over $1,000,000 | A1 | 1 | 1½ | 2 |
| A+ | $750,000 to $1,000,000 | A1 | 1 | 1½ | 2 |
| A | $500,000 to $750,000 | A1 | 1 | 1½ | 2 |
| B+ | $300,000 to $500,000 | 1 | 1½ | 2 | 2½ |
| B | $200,000 to $300,000 | 1 | 1½ | 2 | 2½ |
| C+ | $125,000 to $200,000 | 1 | 1½ | 2 | 2½ |
| C | $75,000 to $125,000 | 1½ | 2 | 2½ | 3 |
| D+ | $50,000 to $75,000 | 1½ | 2 | 2½ | 3 |
| D | $35,000 to $50,000 | 1½ | 2 | 2½ | 3 |
| E | $20,000 to $35,000 | 2 | 2½ | 3 | 3½ |
| F | $10,000 to $20,000 | 2½ | 3 | 3½ | 4 |
| G | $5,000 to $10,000 | ....... | 3 | 3½ | 4 |
| H | $3,000 to $5,000 | ....... | 3 | 3½ | 4 |
| J | $2,000 to $3,000 | ....... | 3 | 3½ | 4 |
| K | $1,000 to $2,000 | ....... | ....... | 3½ | 4 |
| L | Less than $1,000 | ....... | ....... | 3½ | 4 |
| M | Less than $500 | ....... | ....... | 3½ | 4 |
| Blank | | 1 | 2 | 3 | 4 |

In case a customer of the insured has no capital rating with either of the two mercantile agencies at the time when the goods are shipped to him, the company is willing to protect the insured by a coverage agreement based on the rating as given in a special report by the mercantile agency, if issued either three months before or after the shipment. According to the coverage agreement the percentage of the customer's "estimated pecuniary strength," as shown by

[1] The Bradstreet system is similar, except that different notations are used.

Dun's, for example, which may be extended by the insured in the form of credit and will be covered by the policy, varies all the way from 10 to 30 per cent, according to the nature of the business. The limits of credit thus fixed upon are determined by the experience of the company, and it is regarded as vitally important that they should not be exceeded.

3. *The Single Account Limit.*—But the company does not even promise in all cases to cover the customer for the agreed percentage of his financial worth. Instead, it limits its liability on each customer to a specified amount, called the "single account limit." The meaning of this restriction may be illustrated as follows: Let us assume that the policy limits the amount of credit that may be extended to any customer to 20 per cent of his financial rating, and that the "single account" applicable to each customer is limited to $2,000. Now, if the customer is rated as worth from $1,000 to $2,000, the insured will be protected to the extent of $200, i.e., 20 per cent of the minimum capital rating of $1,000. If the customer has a rating of $3,000 to $5,000, he will be covered to the extent of $600 (20 per cent of $3,000); and if worth $10,000 to $20,000, the coverage will equal $2,000 (20 per cent of $10,000). But on all capital ratings in excess of $10,000, the company's liability on any customer will be limited to the $2,000 single account limit. In other words, the coverage percentage of 20 per cent becomes inoperative if 20 per cent of the capital rating for the customer exceeds $2,000. Many instances, however, may arise where business conditions make necessary a larger single account limit, and in such cases, for a special consideration, a larger policy can be agreed upon. The amount for which a company is willing to be liable as regards any one customer will depend upon the nature and the needs of the particular business, and varies from about $1,000 to $25,000.

4. *Credit Insurance Based Upon the Credit Rating.*—The rating system of R. G. Dun & Company shows that this mercantile agency gives each person two ratings, viz., a "capital rating" and a "credit rating." It is apparent that a person's reputation for prompt payment of debts does not necessarily depend upon his estimated financial worth. A person worth $10,000 may be prompter or more reliable in meeting his obligations than another who is reputed to

By this rider attached to and made part of Bond No. ________ issued by The American Credit-Indemnity Co. of New York to John Doe & Co.

it is agreed that the following provisions shall be added to and made part of Section No. 2 of this Bond:

If the governing rating of the debtor is a rating not covered under the body of said Section No. 2, or if it is blank as to capital or credit, or both ("blank blank"), a loss on such debtor, if otherwise coming within the provisions of this Bond, shall be covered to the following extent:

The gross amount covered on any one such insolvent debtor shall be 75 % of the indebtedness at the time of his insolvency but shall be limited to 75 % of $500 gross.

Provided that the aggregate of the net losses to be included in the adjustment under this Bond on all debtors coming within the provisions of this rider shall be limited to 75 % of $4000

The net amounts of proven losses covered under this rider shall enter with the net amounts of all other losses covered and proven under this Bond in calculating under Section No. 6 the amount from which the Initial Loss, to be borne by the indemnified, shall be deducted, and this rider shall in all respects have the same effect as if its provisions had been incorporated in the body of said Section No. 2.

When this rider is attached to Bond the premium is $25.00 per Thousand additional.

**Fig. 20.**—Sample Form of Rider Covering Losses on Debtors of Inferior Rating.

be worth $500,000. For this reason R. G. Dun & Company specify four "credit ratings" after each capital rating, viz., "high," "good," "fair," and "limited." These four grades are usually referred to as first, second, third, and fourth credit ratings.

It should here be noted that credit-insurance companies must, in making their "coverage agreement," take into account the credit rating of the customer. In the "regular" policy this is done by providing that the insured shall be pro-

tected to the extent of a certain percentage of the customer's capital rating only if the mercantile agency has given the customer a first or second credit rating. The companies are willing, however, under special conditions, to cover customers of the insured who may not have such a high rating. Where a customer, for example, has only a third-credit rating the company may agree to cover for a certain amount, on the condition that the insured becomes a coinsurer, usually to the extent of 25 per cent. In other words, where the customer has a first and second credit rating, the company agrees to indemnify the insured to the extent of 100 per cent of the gross sales, provided these do not exceed the agreed percentage stipulated in the coverage agreement or are not in excess of the single account limit. Where, however, the customer has a poorer credit rating, and the company accepts the risk at all, the insured must carry, say, 25 per cent of the risk himself, and to this extent becomes a coinsurer on all sales made.

5. *Maximum Total Liability.*—The credit-insurance policy also provides that the company's liability on all customers shall be limited to a stipulated maximum total. This total liability may be regarded as the face of the policy. In the adjustment of losses under a policy at the end of the policy year it is necessary first to ascertain the sum total of the claims with reference to the coverage agreement affecting the various customers. Next, from this sum total of the claims there must be deducted the initial loss. If the balance of loss should now be so large as to exceed the maximum total indemnity stipulated in the policy, the company will only pay that sum, and the insured must himself bear the excess.

The premium in credit insurance is based upon this maximum indemnity, and the rates of the largest company writing this line of insurance are $50 per $1,000 for the "regular bond" (covering only customers with first and sec-

ond credit ratings) and $75 per $1,000 for the "combination" policy which, besides covering first and second ratings, also includes inferior ratings. According to the literature of the largest company the minimum size of the policy suggested for various volumes of sales is as follows:

| Sales. | Bond. |
|---|---|
| $75,000 | $3,000 |
| 100,000 | 5,000 |
| 150,000 | 5,000 |
| 200,000 | 6,000 |
| 250,000 | 7,000 |
| 300,000 | 7,500 |
| 350,000 | 8,000 |
| 400,000 | 10,000 |
| 500,000 | 12,500 |
| 750,000 | 15,000 |
| 1,000,000 | 25,000 |
| 1,500,000 | 30,000 |
| 2,000,000 | 40,000 |

The several restrictions explained in the foregoing pages are represented in the policy as follows:

"In consideration of the payment of the premium of.......... dollars, the..................Company insures John Doe against actual loss to an amount not exceeding...............dollars, in excess of an initial or own loss to be first borne by the insured, being...........per cent (but not less than $...........) of the insured's total gross sales and deliveries made between........... day of..........191..and the..........day of..........191.., both days inclusive. Such loss to occur from the insolvency of debtors, as herein defined, between the............day of..........191..and the.............day of............191.., both days inclusive, provided the corporation shall have received notice of insolvency from the guaranteed, on the form and within the period of time hereinafter specified."

SECTION I. COVERAGE: No loss is covered under this policy, unless the debtor had at the time of shipment a capital rating in one of the accompanying credit ratings specified below, in the latest published book of the...........Mercantile Agency; and the ratings in such book are to govern all shipments made from the first day of the month borne by said book to the first day

of the month borne by the next subsequent book. The gross amount covered on any one debtor at the date of insolvency shall be limited to............per cent of the lowest amount of his capital rating, where a first credit rating follows, but shall also be limited to $............gross; and shall be limited to............ per cent of the lowest amount of his capital rating, where the second credit rating follows, but shall also be limited to $......... gross.

6. *Definition of Insolvency.*—Credit-insurance policies also provide that the only losses covered are through debtors becoming insolvent during the term of the policy and in the manner defined, provided notice of such insolvency is furnished during the term of the contract and within twenty days after knowledge of such insolvency is acquired by the insured, or "within fifteen days after the expiration of the contract in case the insured does not receive knowledge of such insolvency in time to comply with the aforesaid condition."

In view of these statements, it is important that the company should carefully define the meaning of the term insolvency. Every policy does this in detail, and the definition generally given is the following:

"Insolvency under this contract is defined to mean: the filing, by or against a debtor, of a petition in bankruptcy or insolvency, under the laws of the United States or of any of the States or Territories thereof, or Canada; the making of an assignment or the execution of a deed of trust or chattel mortgage by the debtor on his stock in trade for the benefit of creditors in general; the sale of the debtor's stock in trade under a writ of execution or attachment; the return unsatisfied of a writ of execution or attachment in favor of the guaranteed or any other creditor; a compromise by the debtor, with a majority, in number and amount, of his creditors; the appointment of a receiver where insolvency is alleged in the application therefor; the appointment of a receiver where insolvency is not so alleged, provided the hereinafter required proof of claim is accompanied by a report of the receiver or by a certified copy of decree of Court showing that

insolvency exists; the absconding of the debtor or the sale or transfer in bulk by the debtor of his stock in trade, provided the hereinafter required proof of claim is accompanied by a report of any mercantile agency or attorney in active practice in the county where the debtor did business, certifying that such account is not collectible, by law or otherwise; the death or insanity of a sole debtor, provided the hereinafter required proof of claim is accompanied by a report of the debtor's executor, administrator, or guardian, or by a certified copy of judgment or decree of Court showing that the estate is insufficient to pay the debts in full; the accounts of debtors who owe the guaranteed not more than $150, and who have ceased to do business, provided the notice of insolvency is accompanied by the report of any mercantile agency or attorney in active practice in the county where the debtor did business, certifying that such account is not collectible by law or otherwise; any judicial determination that the debtor's assets are insufficient to pay his debts in full."

*Salvage.*—There has been much discussion during the last few years concerning the wisdom of creating a salvage department in the field of credit insurance. In fire insurance more and more emphasis is placed upon "fire prevention," with a view to reducing the enormous annual waste. In employers' liability insurance, steam-boiler insurance, and corporate suretyship, the companies aim to reduce losses to a minimum through a system of stringent supervision and inspection, and a very considerable part of their premium income is expended for this purpose. All appreciate that little good is accomplished directly by merely underwriting risks and paying losses as they occur. But insurance companies can render the business community an invaluable service by devoting their information and highly developed organization to the creation of ways and means which will reduce the sum total of loss. Indeed, it is well recognized that more can be made by charging low premiums, and seeing to it that there are fewer losses, than by charging high premiums and paying the larger losses that result from careless and uncontrolled conduct in business.

Unlike other leading forms of insurance, credit insurance has not yet been used to an appreciable extent as a means of preventing loss. And yet the loss of several hundred million dollars of credit annually through insolvency shows that there is a field here in which credit insurance can render a very useful service. Credit insurance should have for its purpose not merely the payment of losses, but also the control of all accounts that have failed or are about to fail. Through its efficient organization the credit-insurance company could administer insolvent estates at a greatly reduced cost. It would be to its interest to prevent the heavy losses so frequently resulting from bankrupt sales by seeing that the stock of an insolvent concern is sold at the highest possible price. Its efficiency in handling doubtful accounts might also save many an embarrassed business from going under. And where the business fails, its prompt and intelligent action would certainly result in a reduction in loss as compared with the loss resulting from disconcerted action of creditors when acting individually.

At present credit-insurance companies place the entire burden of proof of loss upon the insured. The policy expressly provides that the insured shall endeavor to obtain all amounts possible on covered insolvent accounts, and shall use due diligence in the filing of claims with referees in bankruptcy, receivers, assignees, or other proper officers for the purpose of having such claims allowed. Because of this provision and also because of the further provision in the policy that proofs of claim must be furnished to the company "within thirty days after the expiration of this contract, otherwise there shall be no liability under this contract," it is sometimes impossible for the policy-holder to obtain proof as required.

In contrast to this method, one company, The London Guarantee and Accident Company, has recently introduced into its policy an agreement which it terms the "Guaran-

teed collection service." Under the definition of "insolvency," this company considers as proven any loss on any account covered by the limits of the policy which is not collected by the salvage department within a specified time after it has been placed for collection. This time is usually limited to sixty days. The salvage department will also take accounts which are not covered by the terms of the policy; that is to say, the company is willing that the policy-holders should use its service on all occasions. For this collection service, the usual collection fees are charged. In this way the insurance company offers cooperation and protection to the policy-holder before an account is actually lost, and prevents the insured's losses from exceeding the initial loss, thus protecting itself from the payment of claims. On the other hand, it may prevent the losses from reaching the initial loss, thus benefiting the policy-holder. By reducing the initial loss, there would in due course of time also result a decrease in the size of the policy required and the premium charged.

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Jersey, 1906; New Mexico, 1909; New York, 1909; North Carolina, 1905; North Dakota, 1905 and 1907; Ohio, 1904; Oregon; Pennsylvania, 1908; Rhode Island, 1902; South Dakota, 1907; Tennessee, 1907; Texas, 1905; Utah; Vermont, 1905; Virginia, 1905; Washington, 1909; West Virginia; and Wisconsin, 1908.

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## V. CREDIT INSURANCE

NOTE.—The bibliography on credit insurance is very scanty, and most of it consists of brief articles published in the insurance press, or of pamphlets issued by the companies.

A Symposium of Credit Insurance Arguments. Prepared and published for the exclusive use of agents of the American Credit Indemnity Co. of New York.

Collateral on Merchandise Accounts. Issued by the American Credit Indemnity Co. of New York. (This booklet contains a description of credit insurance underwriting, and also contains a number of valuable papers on the subject, by W. E. Schweppe, A. S. Keady, Jos. G. McClurg, and J. A. Taylor.

Credit Insurance Explained. A pamphlet issued by the American Credit Indemnity Co. of New York.

Credit Insurance in Brief. A pamphlet issued by the American Credit Indemnity Co. of New York.

PRENDERGAST, "Credit and Its Uses," D. Appleton & Co., New York. Chapter on Credit Insurance. (This chapter deals only with the theoretical aspects of the subject.)

The Report of the New York and Massachusetts Insurance Departments on the Condition of the American Credit Indemnity Company. (This report of 128 pages contains valuable information concerning the nature of credit insurance and the practices in the business.)

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